A United Front for the Common Objective to Understand China’s Economic Growth: A Case of Nonantagonistic Contradiction, Wu vs. Woo*

WING THYE WOO*

WING THYE WOO is Professor in the Department of Economics, University of California at Davis, and Director of the East Asia Program at the Center for Globalization and Sustainable Development at Columbia University. His recent publications include Economies in Transition: Comparing Asia and Europe (MIT, 1998); The Asian Financial Crisis: Lessons for a Resilient Asia (MIT, 2000); “The Relative Contributions of Location and Preferential Policies in China’s Regional Development: Being in the Right Place and Having the Right Incentives,” China Economic Review 13, no. 4 (2002; with Chinese version published in Jingji Yanjiu [Economic Research], September 2002, no. 9); and “The Consequences of China’s WTO Accession on its Neighbors,” Asian Economic Papers 3, no. 2 (Spring 2003). He can be reached at <wtwoo@ucdavis.edu>.

*This “Woo-Wu Dialogue” is a debate between Wing Thye Woo and Yu-Shan Wu on the opinions and ideas found in Wu’s earlier work, “Chinese Economic Reform in a Comparative Perspective: Asia vs. Europe,” that appeared in Issues & Studies 38, no. 4/39, no. 1 (December 2002/March 2003), a special “State of the China Studies Field” double issue.

*I would like to thank the editors of Issues & Studies and Professor Yu-Shan Wu for making this dialogue possible. I am also much indebted to my collaborators in my transition-related research for generously sharing their creative ideas with me and for having painstakingly taught me so much about the histories and the workings of transition economies, and to Hong Chang for excellent research assistance.

* Institute of International Relations, National Chengchi University, Taipei, Taiwan (ROC).
Economic growth is difficult to understand. If this were not the case, the whole world would be rich already. In the absence of controlled laboratory experiments, we are often forced to settle for comparative analysis of national experiences as the default methodology by which to identify the mechanisms of economic growth. One enduring lesson that painful experience has taught scholars of economic growth is that the dazzlingly bright idea of the moment about what specific factor really causes economic growth will inevitably turn out to be just another blinding insight, where the cleverness of the idea blinds us temporarily to the partial nature of the correctness of the explanation—it being applicable only to a small sub-sample of countries, and then only for a limited sub-period in their history. The one thing about economic growth that we can be reasonably sure about, despite our admittedly incomplete understanding of the phenomenon, is that no single variable, or two—or even three—variables, can constitute an adequate explanation. The most optimistic and kind remark that one can make about any big idea currently in vogue is that it deserves incorporation into the melting pot of ideas.

It is within this context that this essay appraises Professor Yu-Shan Wu’s attempt, in an earlier “State of the China Studies Field” special issue of *Issues & Studies*, to explain why the output performances of China and Russia have been so different in their transition from command to market economies.¹ He identifies from the literature a set of variables that have been employed to explain economic growth in China and Russia, and he classifies the variables under two analytical approaches. The *non-institutional* approach encompasses explanations that appeal to differences in culture, stage of economic development, international environment, and pre-reform system; the *institutional* approach covers explanations that emphasize differences in reform philosophy, speed of reform, and property rights restructuring. Wu’s conclusion is that only the institutional approach can explain the different output responses in China and Russia to their respective economic reforms.

Wu’s analysis is based on a careful and critical reading of the voluminous literature on the subject, and the many dazzling observations made on these two countries will ensure that Wu’s article earns “required reading” status on the reading lists of courses on China’s economy. My assessment of Wu’s contribution is a cautious one, however, because it is humbled by Zhou Enlai’s (周恩来) famous

---

answer to the question about what he thought about the achievements of the French Revolution, which was that “It is still too early to say.” My caution therefore limits me to hazard the tentative verdict that there are three fundamental shortcomings in Wu’s paper: (1) the methodology of his analysis is logically flawed; (2) the central concepts introduced in his analysis are analytically vacuous; and (3) some parts of the historical narrative are factually incomplete, and some parts are politically naive. These three flaws are examined, respectively, in the first three sections of this paper. A final section puts our disagreement within the context of the larger debate in the transition economics literature and offers some preliminary conclusions.

It is important to stress at the outset that my contradiction of Wu’s masterful analysis should be understood within the framework proposed by Mao Zedong (毛泽东) in his seminal article “On the Correct Handling of Contradictions Among the People.” Mao Zedong Thought identifies two types of contradictions: “those between ourselves and the enemy” and “those among the people themselves.” The former is antagonistic, while the latter is not. Because Wu and I are engaged in the common enterprise of reducing the cost of economic transition, and are united in the common objective of understanding economic growth, the contradiction between us is assuredly nonantagonistic in nature. It is in this spirit of intellectual comradeship that this critique is written.

Illogical Methodology

Our incomplete understanding of economic growth notwithstanding, I take as a given that economic growth depends on more than one variable. Assuming that we know at least four of the variables that influence economic growth, then one simple characterization of economic growth could be:

\[ y = a_1 x_1 + a_2 x_2 + a_3 x_3 + a_4 x_4 + e \]

---


where \( y \) = trend growth rate of output; \( x_i \) = factor \( i \); \( a_i \) = (relative) impact that factor \( i \) exerts on the growth rate; and \( e \) = residual factors (a measure of our ignorance).

However, because many examples suggest that economic growth could be a more complex process than the simple weighted sum of each individual factor, economic growth could well be a nonlinear function of the four variables, as given, for example, by the sum of three composite terms:

\[
y = \left[ \sum_{i=1}^{4} a_i x_i \right] + \left[ x_4 \sum_{i=1}^{3} b_i x_i \right] + e \left[ x_1 x_2 x_3 x_4 \right] + \epsilon
\]

where \( b_i \) and \( \epsilon \) are technical coefficients, and \( \epsilon \) is the new measure of our ignorance.

Specification (2) is interesting because it allows large output changes to occur for a tiny change in any one of the \( x_i \); it also imposes prerequisites in order for a high growth rate to occur. The second and third composite terms become influential only when \( x_4 \) switches from zero to a positive value; a real world equivalent of \( x_4 \) could, for example, be “law and order.” The third composite term has no influence on growth when any one of the \( x_i \) is zero, denying economic growth the “synergy effects” from virtuous circle type of interactions. The important point from either specification of economic growth is that it is logically wrong to test for the impact of \( x_i \) on \( y \) solely by checking whether the movements in \( x_i \) are synchronized with the movements in \( y \). Such a testing methodology is valid only if the values of \( x_2, x_3, \) and \( x_4 \) are constant during the period of the analysis.

Wu dismisses the relevance of the “culture” variable by arguing that “the glacial pace of cultural change simply does not match the dramatic transformation of the economy and the turbulent fluctuations of performance.” This dismissal is unconvincing for two reasons. First, there is no reason to believe that something as complex as culture could have only a linear impact on \( y \); it could very plausibly exert a nonlinear influence like that of \( x_4 \). Second, one cannot accept as true the claim that, except for culture, the values of the other variables stayed unchanged in the last two decades in China as well as in Russia.

Wu also rejects an explanatory role for the stage of economic development in the output response to economic reform by pointing out that “backwardness certainly
does not guarantee high growth” (emphasis added). No one will dispute the veracity of this statement because almost everyone will agree that economic backwardness will persist unless there are deliberate changes in the policy regime that will result in the restoration of law and order, the implementation of a minimum critical mass of economic deregulation, and the construction of adequate infrastructure to overcome geographical barriers; or unless there are unexpected changes in the resource base, like the discovery of oil.

To see this point more fully, note that for a substantial length of time in the 1990s, Mongolia enacted the same free-trade and liberal foreign direct investment (FDI) policies that had been implemented in China’s free-trade enclaves (e.g., the Shenzhen Special Economic Zone), yet Mongolia did not achieve an export-led boom fueled by foreign capital inflow. The reason is obvious: Mongolia’s geographical isolation prevented such a phenomenon from occurring. This is exactly why, despite the extension of almost the same free-trade and liberal FDI policies to the other Chinese provinces since 1994, the inland provinces have continued to grow slower than their coastal brethren. Geography matters because it helps to determine the wealth potential of the location, while the degree of backwardness matters because it affects the speed at which the economy moves toward its potential frontier provided that economic deregulation and the rule of law are already in place to enable the market to operate smoothly.

Wu’s rejection of the “stage of development” variable as relevant to why output growth has differed in China and Russia is hence unjustified in two important ways. First, he unreasonably demands that this one variable explains all of economic performance. This condition is akin to the expectation that an Einstein born in rural sub-Saharan Africa would still be able to realize the full extent of his innate academic potential despite the absence of any formal schooling, least of all a university education. Second, Wu ignores the fact that both Vietnam and Laos experienced large sustained output growth in 1989-96 after these subsistence agricultural economies were given the “shock therapy” treatment of radical macroeconomic stabilization and immediate comprehensive price deregulation in March 1989. The collective China-

---

4 This particular argument for the rejection of the stage of development being an important explanatory variable has also been made by others. See Peter Nolan, China’s Rise, Russia’s Fall: Politics, Economics, and Planning in the Transition from Stalinism (New York: St. Martin’s Press, 1995), 113-14; and Thomas G. Rawski, “Reforming China’s Economy: What Have We Learned?” The China Journal, no. 41 (January 1999): 141.
Laos-Vietnam experiences show that the key to economic growth for transition economies at this stage of economic development is not the speed of reform but the interaction between the direction of reform and the economic structure.

This failure to appreciate the importance of the differences in initial conditions leads Wu, among others, to conclude that Poland and Russia ought to have adopted the Chinese two-track approach. For example, Rana and Dowling have opined that: “The approach of first encouraging the non-state sector [to grow] and then progressively reforming the public sector allows the growing private sector to absorb laid-off state employees, and is thus a relatively painless way of achieving reform.”

The fact is this “humane” flow of workers from the state-owned enterprises (SOEs) to the new non-state enterprises has not occurred in China until very recently. The proportion of the Chinese labor force employed by state-owned units was 18 percent in 1978—and it was still 18 percent in 1992. This means that there were 32 million more Chinese working in state-owned units in 1992 than in 1978. The labor for the new Chinese enterprises came entirely from the agricultural sector. Workers in SOEs did not shift to the non-state enterprises because, thanks to various subsidies from the government, SOEs paid higher wages. SOEs also provided generous pensions, heavily-subsidized housing, medical coverage, child-care, food, and recreational facilities. The Chinese peasants, receiving none of these benefits and consuming only one-third of what urban residents consumed, were hence only too glad to shift out of low-income agricultural activities to the new higher-income jobs.

In Russia, over 80 percent of the population were urban residents and SOE employees in 1991. Furthermore, Russian farmers received the same income as SOE workers. Thus when the new non-state sector was legalized, an SOE worker or farmer shifting into this new private sphere would experience a drop in income because he would not only no longer receive the various subsidies, he would also have to pay taxes to support the subsidies given to the SOEs. The point is that until the subsidies to the SOEs were ended, there was no voluntary movement by workers from the state enterprises to the new non-state enterprises. In short, “growing out of the plan” was not an option for Poland and Russia. The new Chinese enterprises were able to sprout without the SOEs releasing their labor only because of the great

---

reservoir of surplus agricultural workers who were happy to take jobs in the new enterprises that pay less than SOE wage.

Wu then goes on to deny the possibility of “international factors” having had a role in explaining the output performance of China and Russia; he observes that “the performance of European transition economies varies widely, despite the fact that they were all initially knit together under the Soviet command system. ... This variation requires explanation that goes beyond the breakdown of their traditional network—which, after all, was a factor common to all.” Wu’s logic in this instance is subject to the same objections given in the previous two cases. First, the other $x_i$’s in every Eastern European economy could not have stayed unchanged over the period in question, nor could they have moved together in a synchronized manner. Second, there is no basis to expect a uniform effect across Eastern Europe either from the negative shock of the breakup of the Council for Mutual Economic Assistance (CMEA), or from the subsequent recovery from the output collapse. The Eastern European economies were integrated to varying degrees into the Soviet economy, and the geographical location of each Eastern European economy gave them different trade and FDI opportunities vis-à-vis Western Europe. Furthermore, there was no common economic policy response because politics as well as other social conditions differed across countries, prompting country-specific policy responses to the new international environment. In short, there is no reason to expect that international factors would have caused identical output responses in Eastern Europe even if they were responsible for the output fluctuations.

One should notice the fact that Wu switches his testing methodology when he examines the individual validity of the explanations clustered under the institutional approach. At the outset, the criterion took the hard-line form of either the variable being able to account for the entire movement in $y$, or the variable alone being able to “guarantee high growth.” A paradigmatic switch in the intellectual yardstick therefore occurs when Wu concludes from his examination that the reform philosophy explanation “does carry a certain amount of weight in explaining the performance gap.” It is only while discussing the institutional approach that he assigns a causal role to a variable that only contributes to shaping—rather than solely determining—the growth outcome. Wu, however, does not tell us the reasoning process that led him
to determine that the weight was non-zero, and he also does not tell us how far away from zero that weight is.\textsuperscript{6}

Another disconcerting feature also appears at this juncture of the paper. Wu rightly recognizes the speciousness of the “speed of reform” variable in explaining output outcome with the comment that “by focusing attention on the difference in preferred speed rather than content or direction of reform, the shock therapy vs. gradualism debate is misleading.” He somehow still felt comfortable to pronounce in several places in the article, however, that the institutional approach is correct—rather than stating that only \textit{some} of the components of the institutional approach are correct. Furthermore, given the identified muddle-headedness of the general debate between shock therapy and gradualism, it is somewhat of a mystery why Wu felt obliged to discuss this debate extensively in later sections in a seemingly sympathetic manner that appears to lend credence to the usefulness of this dichotomy—after he had professed otherwise earlier on.

\textbf{Analytically Vacuous Key Concepts}

To reiterate, the key concepts introduced in Wu’s paper are the non-institutional and institutional approaches. There are two basic problems with this articulation. First, he does not supply an operational definition that allows the reader to differentiate non-institutional explanations from the institutional ones. Second, his use of the term “institution” is extremely idiosyncratic and deviates far from the normal usage of the term. Wu tells us that the explanations which regard differences in the pre-reform systems of China and Russia as important determinants of their subsequent output paths all belong to the non-institutional approach. He rightly notes that the crux of this explanation is that “the shorter the \textit{institutional} distance between the pre-reform system and the target system, the easier is the transition” (emphasis added). The reader is left flummoxed, however, by how a non-institutional explanation can rely on something identified as the \textit{institutional} distance. Just when does a non-institution begin acquiring institutional characteristics?

The emptiness of the term “institution” in Wu’s argumentation is independently confirmed by usage that deviates from the normal meaning. Why is the speed of

\textsuperscript{6} Wu’s provocative identification of the competing reform philosophies as being rationalism for Eastern Europe and empiricism for China will be challenged later in this critique.
policy implementation considered an institution while the degree of central planning is not? Furthermore, because anthropological studies have shown that the ownership pattern in many societies follows from their cultural presumptions, why does Wu classify ownership pattern, but not culture, as an institution? This seemingly idiosyncratic use of language certainly makes the reader question whether Wu’s central analytical concepts have operational definitions that are meaningful and useful.

**Factually Incomplete and Politically Naive Historical Narrative**

Wu claims that rationalism is the reform philosophy of Russia, and empiricism the reform philosophy of China. He traces these choices of philosophies to “the European reformers ... [who, being] ardent disciplines of neoclassic economics, ... aspired to transform the command economies of their countries to idealized nineteenth-century libertarian capitalism”; and to the Chinese reformers being non-ideological realists who conducted economic experiments to guide their policies. The resulting policy translations of these two different reform philosophies were hence “big bang” reforms and gradual reforms, respectively.

Wu’s interpretation of history strikes this reader as incomplete and naive. First, he accepts at face value the official Chinese explanation for why China had reformed in a piecemeal manner—rather than recognizing the incremental approach as being a reflection of the schism within the Chinese leadership. Second, Wu disregards important parts of the Soviet reform experience where Chinese-style reforms were actually implemented but failed to produce the same salubrious effects as in China.

The role of politics in the choice of reform policies can be seen by asking why Poland in 1991 did not opt for Chinese-style partial reforms even though this strategy had produced ten years of respectable growth in China. The reason is that there exists in Polish and other Eastern European societies a basic consensus on what the final shape of their societies should be. The Eastern Europeans wanted to rejoin Europe, and so the reform debate there was mainly about the speed—rather than direction—of reform.

In contrast, the Chinese elite in 1978 was split between the conservative reformers led by Chen Yun (陳雲) and the liberal reformers headed by Hu Yaobang
The conservative reformers subscribed to the “bird cage economy” doctrine. In the conception of its originator, Chen Yun, the central plan is the cage and the bird is the economy. The premise is that without central planning, the economy will be mired in chaos and production will be inefficient—i.e., without the cage, the bird will fly away. The amount of market activities that could be tolerated to keep the economy working was considered analogous to the degree to which the cage needs to be swung in order to create the illusion of greater space that is required to keep the bird happy. The liberal reformers, on the other hand, believed that only a private market economy could develop China—understandably, they were careful to omit the word “private” in their descriptions of reform goals.

Given this clash in vision, it was inevitable that China’s economic reform in the early years was schizophrenic in operation—e.g., capitalist free-trade enclaves were allowed in the southeastern provinces (far away from Beijing), and individual (or small groups of) villagers in some areas could establish and operate sizable industrial enterprises provided that these were formally registered as collectively-owned township and village enterprises (TVEs). The artful word employed to rationalize this policy schizophrenia was “policy experimentation.” Because the debate in China before 1992 (when mother Russia officially turned capitalist) could not agree on the direction of reform, this ruled out the possibilities of marketizing quickly and comprehensively, giving equal legal recognition to private enterprises, and undertaking significant privatization of state enterprises.

Since the main reason behind gradualism in the pre-1994 period is the absence of political consensus over what the final state of affairs should be, gradualism should not be likened to a person putting on his pants one leg at a time nor should “big bang” be viewed as a person jumping excitedly into his pants. The more accurate picture of gradualism is a person putting one leg into the pair of pants—and then stopping for a meditative smoke because he is insecure about whether or not he would be better off with a fig leaf or a loin cloth instead. Big bang, on the other hand, is the equivalent of

---

7 Deng Xiaoping (鄧小平) supposedly played the mediating role, but he occasionally tilted his hand in support of the liberal reformers.

8 In retrospect, it is incredible that some usually critical-minded analysts actually believed that it was necessary to conduct experiments to ascertain that market incentives could be efficient economic mechanisms in China. After all, markets were the organizational norm of China’s economy before 1952, and markets constitute the organizational norms in all of China’s wealthy Asian neighbors.
a person who, while putting his first leg in, cannot wait to add his second—with the sequencing of actions but a minor detail.

With the collapse of the Soviet Union in August 1991, and given the steady pace of deaths of the conservative reformers since then, China has now officially embraced the vision of “a socialist market economy with Chinese characteristics,” a term which counts among its unique aspects the privatization of state enterprises, the granting of equal legal status to private property, the admission of capitalists into the Central Committee of the Chinese Communist Party (CCP), and the extension of national treatment for foreign banks. The debate over reform direction is now over, as is the official rhetoric about the need to conduct economic experimentation to see if standard capitalist market mechanisms (like the stock exchange) would work in China’s particular economic setting.

To sum up, contrary to Wu’s narrative, the gradualness of China’s reform was not the result of Chinese reformers being non-ideological realists; it was the product of ideological roadblocks put up by bird-brained conservative reformers. Wu was similarly wrong when he depicted the bang reforms of Poland and the Czech Republic as consequences of free market ideology. Rapid reforms were possible in this region because there was no ideological debate in any Eastern European country over whether to seek a third way between European welfare capitalism and Stalinist socialism. The simple truth is that the typical Eastern European reformer is no less realistic, and no more ideological, than the average liberal reformer in China—they both put their pants on in the same way, which is one leg at a time.

An excellent account on the Soviet economy by Anders Åslund, which was consulted by Wu, makes clear that market reforms in Russia did not begin with the Boris Yeltsin government in 1992. The gross inefficiency of the Soviet economy and its slide into technological stagnation during the nomenklatura communism of Leonid Brezhnev in the 1970s had fermented much reformist thinking among Soviet economists. By the time Mikhail Gorbachev assumed political power in May 1985, there were already many established influential economists urging market-oriented reforms—e.g., Boris Kurashvili argued for Hungarian-style market socialism, and Oleg Bogomolov for Chinese-style incremental liberalization. Gorbachev accepted the need for these “radical reforms” only after spending two years in an abortive effort to propel the economy out of the doldrums by accelerating the technological level of Soviet industries via large investments in the machine tool industry.
The influence of China’s reform strategy is clearly seen in Gorbachev’s arguments for “radical reforms” in 1987 “in favor of family contract, family teams and … leasehold” to be introduced in Soviet agriculture. In June 1987, the Soviet economic plenum passed the Law on State Enterprises and Basic Provisions for Fundamental Perestroika of Economic Management in order to devolve decision-making power from the ministries to the SOEs. Just like in China, Soviet SOEs were given more freedom in their output choices, as well as the freedom to enter into long-term contractual agreements for purchases and sales; they were allowed, moreover, to retain part of their profits to use at their discretion (e.g., for technological upgrading and as incentive bonuses). Also as in the China case, deliveries to the state would be reduced over time to cover only 40-60 percent of all production.10

The explosive growth of China’s non-state industrial sector had made a deep impression on the Russian reformers and inspired them to push for a double-track ownership system as well. Academician Leonid Abalkin, a prominent leader in reform thinking, predicted in 1986 that the radical reforms of Gorbachev would enable cooperatives to account for 10 percent, and private enterprises for 4 percent, of GDP within a decade.11 Various decrees had been issued earlier to stimulate the cooperative sector, and they were greatly expanded with the adoption of the Law on Cooperatives in May 1988.

The Law on Cooperatives was categorical in making the formation of cooperatives an easy task: “A cooperative is organized at the desire of citizens, exclusively on a voluntary basis. The creation of a cooperative is not conditional upon any special permission whatsoever by Soviet, economic or other bodies.”12 There was no ceiling set on the number of members, nor was there a limit placed on the number of non-members that could be hired on contract. Furthermore, cooperatives could set their prices according to market conditions. Yevgenii Yasin, a senior member of the State Commission on Economic Reform, stated: “The 1987


11 Åslund, *Gorbachev’s Struggle for Economic Reform*, 168.

12 Quoted in ibid., 169.
reform was in many ways an attempt to implement the Chinese model in Russia. It envisioned enterprises, and joint ventures would constitute the free sector, existing alongside the state sector, with its mandatory state orders, fixed prices, and centralized allocation of inputs.\footnote{Ellman and Kontorovich, \textit{The Destruction of the Soviet Economic System}, 169.}

The Soviet economy began disintegrating from 1989 onward, however. The reasons for this disintegration are complex. Sachs and Woo made the point that the existing heavy industrial sector was too large for a marketized Soviet economy—this sector had to shrink because its value-added at market prices was negative.\footnote{Jeffrey Sachs and Wing Thye Woo, “Structural Factors in the Economic Reforms of China, Eastern Europe, and the Former Soviet Union,” \textit{Economic Policy} 18 (April 1994): 101-45.} Kornai has advanced the hypothesis that systemic stability is assured only when the regime in the political sphere is compatible with the regime in the economic sphere.\footnote{Janos Kornai, \textit{The Socialist System: The Political Economy of Communism} (Princeton, N.J.: Princeton University Press, 1992).} A totalitarian communist regime that is ideologically committed to the suppression of private ownership requires for its sustenance a centrally-planned economy, and vice versa. If the nature of the regime changes in only one sphere, then the stability of the regime in the other sphere will be disturbed, culminating in systemic collapse. This means that unless partial marketization is matched by an appropriate modification in communist ideology, either the economic reform will be reversed or the existing political regime will be toppled. Hence, in Kornai’s framework, the 1987 Chinese-style reforms removed the last vestiges of coherence within the Soviet political-economy system and thereby precipitated its collapse.

However, judging by how dramatically Gorbachev reacted to the failure of his Chinese-style reforms, it is clear that there were much more immediate (if not also much more important) causes than the two given in the preceding paragraph. Gorbachev responded to the worsening economic situation first by replacing Leninist democratic centralism with open popular elections, and then by authorizing academician Stanislav Shatalin to draft a plan that would transform the planned economy to a market economy in 500 days.\footnote{For details, see G. Yavlinsky et al., \textit{500 Days: Transition to the Market} (New York: St. Martin’s Press, 1990).} These actions suggest that Gorbachev had concluded that the biggest obstacle to the development of a market economy was
the Communist Party itself, and that gradual reforms could not work in the Soviet
Union.

Based on the above discussion, I believe (unlike Wu) that the Russian case
offers important positive lessons for China—not just important negative lessons.
Given the situation China faces in early 2003, I see two cogent positive lessons. The
first derives from the fundamental message in Kornai’s analysis that true systemic
stability requires that the political regime be compatible with the economic regime.17
Sustained economic prosperity requires a market economy that is integrated into the
international economy, and a true market economy requires (constitutionally-
protected) private ownership to be its institutional norm. The lesson for China from
the Russian case is that the avoidance of economic disruptions from political
upheavals lies in the willingness and ability of the ruling elite to make adroit changes
to the nature of the political regime to accompany the changes in the economic regime.
Seen in this light, China’s aggressive push for World Trade Organization (WTO)
membership, the recent revision of China’s constitution to give private property the
same legal status as public property, and the reduction of the central bureaucracy by
over a third since 1995 are all signs of far-sightedness in the third generation of
Chinese leaders. The recent election of capitalists into the CCP Central Committee
should therefore only be the beginning of the restructuring of the Communist Party—
a necessary evolution if the CCP is to have a strong chance of remaining a powerful
political force in the long run.

The second lesson for China from Gorbachev’s reforms derives from the fact
that the primary political opposition to marketization came from within the Party and
that the primary resistance to implementation of reforms came from within the
government. Because the policy dissent and implementation sabotage are of the in-
house variety, purges could destroy the internal unity required both for the political
survival of the ruling elite and for the maintenance of stable center-provincial political
arrangements. The lesson is thus that the fourth generation of Chinese leaders will
have to come up with creative mechanisms to offset the natural proclivity of loyal
party incumbents to favor the status quo over additional institutional reforms.

These two lessons have reinforced my skepticism about the now almost
folkloric belief among many East Asian-watchers, Wu included, that

17 See note 15 above.
“authoritarianism is a prerequisite for economic development at least during its early stage.” Peter Nolan has in fact concluded that:

The continuation of strong state apparatus, even in the hands of the Communist Party, may well be the least bad vehicle for leading the de-Stalinisation of the economy in the impoverished socialist economies, given the range of realistic possibilities facing them. Indeed, it is possible that post-Stalinist economic progress may for some time to come be greater in the “Market Stalinist” countries (i.e., Vietnam, China, and perhaps even North Korea) than in those former socialist countries, which for completely understandable reasons overthrew their communist parties tout court.18

These are idle speculations with only socially deleterious consequences all around. I see nothing in the February 28 massacre in Taiwan in 1947 that contributed positively to the sustained high growth which began a decade later, and I know of no one who has claimed otherwise. The country that invented the East Asian developmental model, Japan, had neither a dictatorship nor a military-led government (as in Indonesia, South Korea, and Taiwan) during its post-World War II leap into the ranks of the richest economies. Malaysia is another counter-example to this belief. The point is that sustained economic reforms do not require Stalinist-style political repression; what is definitely required is a commitment by the political leadership to economic prosperity and not to ideological purity. The sustenance of the political commitment to reforms, in turn, requires the quick forging of a pro-growth coalition. As coalition-building—regardless of the nature of the political system—depends strongly on particular circumstances and individual political shrewdness, the belief that the donning of the brown shirt of fascist repression is at least necessary for the initiation of viable growth cannot be justified. In light of the present trends in Russia, I do not find convincing the argument that the institutionalization of democracy—as evident by the peaceful replacement of the democratically-elected Yeltsin by the democratically-elected Putin—has predestined Russia to continued failure in economic growth. Nor do I find it remotely credible that ripping the brown shirt off the body politic will lead to the economy losing its shirt.

Conclusion

Professor Yu-Shan Wu deserves our thanks for his bold tackling of such a thorny subject—the contentiousness of which is aptly captured in the titles of two recent books: *The China Miracle* by Justin Lin, Fang Cai, and Zhou Li, and *Growth Without Miracles* by Ross Garnaut and Yiping Huang. The answer to the source of China’s growth is of more than academic interest because it also provides the correct way to think about China’s growth after WTO membership. Specifically, China’s future growth performance depends on whether past successes were (1) the result of China’s economic experimentation that produced non-capitalist institutional innovations that were optimally suited to the country’s particular economic circumstances, or (2) the result of China’s institutional convergence and integration with the advanced WTO economies like France, Japan, and the United States. In an earlier work, I labeled these two competing interpretations of China’s post-1978 economic history—institutional innovations vs. institutional convergence—the Experimentalist School (E-school) and the Convergence School (C-school), respectively. Wu is an unabashed member of the E-school, and I am a card-carrying member of the C-school.

The E-school holds that gradual, piecemeal reform is superior to rapid, comprehensive reform because economic experimentation—on different degrees of price flexibility, different types of SOE contracts, and different forms of ownership structures—are necessary in order to discover the institutional features that are optimal for China’s specific economic conditions. Gradual reform is viewed as the by-product of the time-consuming processes of undertaking economic experimentation, of verifying the initial results in other locations, and of propagating the new institutional innovations nationally.

Members of the E-school have given considerable sympathy to the interpretation that hybrid institutions (such as TVEs) reflect a variety of distinctive Chinese circumstances. For example, Weitzman and Xu attribute the collective

---


ownership of China’s rural enterprises to the unusually strong sense of brotherhood, germenxing (哥儿们性), among Chinese. However, if this culture-based explanation is correct, then the fact that almost all the rural enterprises in Taiwan are privately owned will imply either that the Taiwanese are not culturally Chinese or that the jackboot of Kuomintang (國民黨) rule (until the mid-1980s) had extirpated Chinese culture from the Taiwanese countryside. Neither reason is plausible, of course. The collectively-owned pattern of rural enterprises in China (which has declined drastically since 1994) reflected the prosaic fact that private ownership in the countryside until 1994 was heavily discriminated against, if not banned outright. This TVE example illustrates why the general tone of the C-school is that the E-school has made economic virtues out of political necessities in China’s uneven and drawn-out reform process.

In another work, I have suggested that dual-track pricing was the product of political constraints and not of economic optimization, and hence was nonviable beyond the short run. The C-school has long deemed the privatization of the bulk of the SOEs to be both inevitable and desirable, though it has worried and continues to worry that privatization must be carried out transparently and honestly, lest the corruption that characterized Russian privatization undermine the very economic goals that privatization is designed to support. In essence, the C-school has argued that the institutional infrastructure that China needs at this point to move from a low-income country to an upper-middle income country can be achieved mainly by adopting the best international practices in the different spheres, and then modifying them as experience accumulates (in China and elsewhere in the world). The East Asian experience, being the best case of “catch-up” industrialization that the world offers, is thus the most relevant. Even there, however, changes over time in international markets suggest that blind adherence to some earlier formula will not succeed in the present—or future—context.

Consequently, I have serious reservations about Wu’s enthusiasm for the adoption of the “East Asia’s capitalist developmental model” by today’s transition economies. This model is based on many mercantilistic practices by the states that the

---


United States wanted as frontline allies during the Cold War, and such practices are now unlikely to be tolerated by the advanced developed countries (especially those that involve systematic violation of intellectual property rights). Japan’s decade-long malaise makes clear that the East Asian developmental model is for catch-up development, and has to be drastically modified once the country has arrived at the international technological frontier. However, given the much stricter rules on international trade under the WTO, even the model for developing economies has to be significantly amended.

The experimentalist and convergence points of view are themselves converging to some extent, especially under the glare of real events. On the one side, almost all of the experimentalists now concede that China will become a “normal” capitalist economy, characterized by private ownership, the corporate form of organization in large organizations, and adherence to international rules of the game in trade and finance. The accession to the WTO has put “facts on the ground,” as it were. At the same time, the C-school has further strengthened its emphasis that there is no model worthy of blind adherence since there is considerable variation in actual practices among the United States, Western Europe, and Japan (not to mention smaller economies such as Korea and Singapore). Moreover, in many critical areas—such as social policy, social insurance, science and technology policy, and regional development, some experimentation is surely needed given that even the market economies have settled on no clear recipes.

Even though views are converging, there are still differences in emphasis, and therefore in forecasts about the future. The E-school tends toward pessimism regarding China’s accession to the WTO, since this will force even more institutional harmonization; the C-school is inclined toward optimism for the same reason: WTO membership will require that China further harmonize its key economic institutions with those of the leading market economies. The experimentalists are understandably uneasy about the external constraints over economic experimentation, while the convergence school believes that China will continue to benefit from the adoption of “best international practices.”

Having now put Wu’s seminal contribution within the broader context of the literature and its evolution, this critique offers three conclusions specific to the issues raised by him. The first conclusion is that the different results that we see in China, Vietnam, Poland, and Russia immediately after the implementation of different
economic reform programs stem more from their differences in economic structure than from the economic strategies implemented. The reform problem of both China and Vietnam is the classic development challenge of moving surplus agricultural labor into industries; Poland and Russia, however, face the classic adjustment problem of moving employed labor from uncompetitive industries to newly-emerging efficient industries. The fact is that economic development is easier than economic adjustment both practically and politically.

The second conclusion is that the Chinese approach was possible only because the economy was blessed with a small SOE sector. China’s SOE sector was small enough that its financial drain did not bring money creation to a level sufficient to cause hyperinflation. Equally important was that the small number of SOEs made it possible for the government to retain some control over the enterprises, especially over their fulfillment of production quotas at plan prices. With the state still being able to monitor the SOEs until the early 1990s, there was no need at the time to consider immediate privatization because widespread spontaneous privatization did not occur. Embezzlement in the SOE sector in 2003 is so very rampant that it is undermining the legitimacy of CCP rule. The problem is that the mass privatization experiences in the other transition economies have shown that corruption is also endemic in the privatization process regardless of the privatization method used, and that such corruption has helped to reduce the political standing of key reformers—such as Anatoly Chubais and Vaclav Klaus. The relevant issue for the fourth generation of Chinese leaders is whether China is now in the situation where the political cost of a corrupt SOE sector is higher than the political cost that will be created by the corruption and unemployment associated with the privatization process.

The third conclusion is that the failure of Gorbachev’s 1987 reforms suggests not only the limited applicability of China’s double-track transition strategy to the economies of Eastern Europe and the former Soviet Union, but also that the greatest challenge to the deepening of economic reform and opening may come from the entrenched interests within the ruling structure. China’s recent WTO accession could well have been partly motivated by the political need of the liberal reformers to lock economic policies on to a course for further marketization and internationalization that is too costly to reverse.

Finally, in the spirit of the correct handling of contradictions, I must note that I arrived at these three conclusions which differ from those of Wu only because
younger scholars like myself have the strong shoulders of the established scholars (like Wu and others) to stand on, and hence can see a different view. This image of helpful shoulders is key to the correct interpretation of the official Chinese justification of their incremental reform procedure “mo shi guo he” (摸石過河, crossing the river by groping for stones to bear one’s weight). The reason why the Chinese peasant is crossing the river slowly is because the CCP is standing on her shoulders, and the CCP may fall into the river should the peasant experience a moderate stumble. In short, fast and comprehensive reversal of decades-long economic polices is politically delegitimizing for an incumbent political party because such an action is tantamount to confession of entrenched gross incompetence.

This reading of the situation mirrors Alexis de Tocqueville’s famous observation in 1856 that the most dangerous moment for a bad regime is when it begins to reform itself.\footnote{Alexis de Tocqueville, \textit{The Old Regime and the French Revolution} (Chicago: University of Chicago Press, 1998).} This means the faster and more complete the repudiation of the past, the more vulnerable is the ruling group to political suicide—unless it not only had little or no ties with its predecessor but had also come to power over the strong opposition of its predecessor. This was the case of Lech Walesa in Poland and of Vaclav Havel in the Czech Republic. The repudiation of Mao was definitely not a card that the CCP could play in 1978 (or even now); this explains why the CCP officially ruled in 1981 that Mao was 70 percent good and 30 percent bad—despite the fact that many of the top CCP leaders had experienced some hunger during the Great Leap Forward, and suffered greatly during the Cultural Revolution. Deng Xiaoping and the liberal reformers were cognizant of this political pitfall in economic reform, which was why they were only too happy to go along with the myth that the way out of the economic mess was via extensive yet careful economic experiments. This insistence on the need to reinvent the wheels of modern industry and commerce necessarily meant a delay in marketization, a situation that the conservative reformers (being supporters of the bird-cage economy) were only too happy to endorse. Simply put, the difference in the reform procedures in China and Russia reflected not different reform philosophies between the market-oriented economists in China and Russia but different political constraints facing them in their countries. Partly thanks to being able to stand on the shoulders of political scientists (including those of
Professor Yu-Shan Wu), I was able to see this basic point when I put my sole into my work.