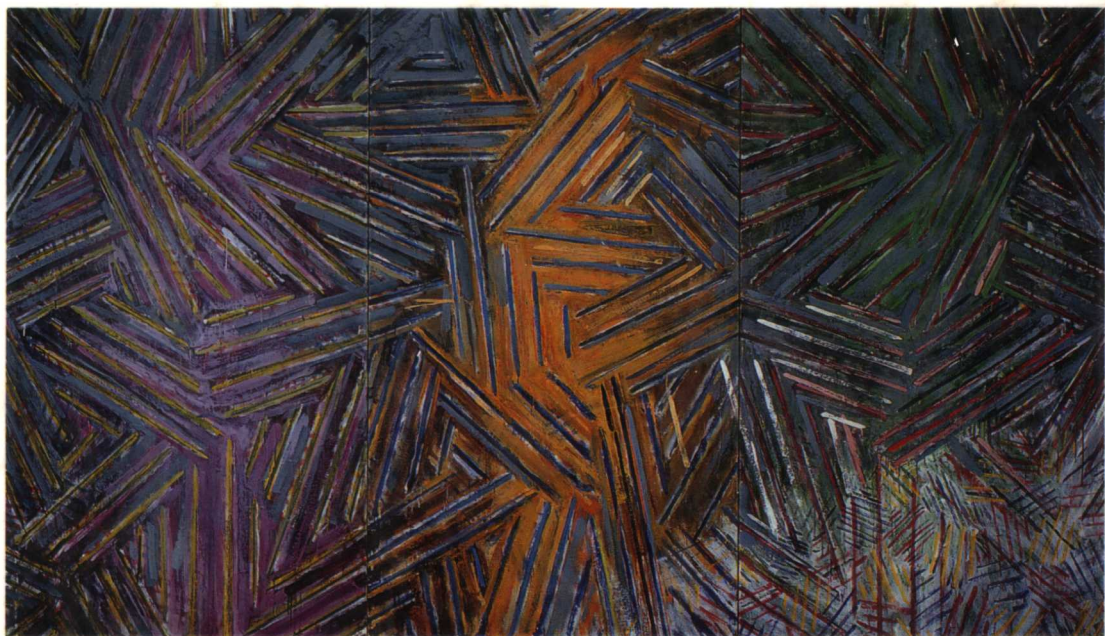


COMPARATIVE ECONOMIC SYSTEMS

Fourth Edition



Gregory / Stuart

Comparative Economic Systems

Fourth Edition

Paul R. Gregory
University of Houston

Robert C. Stuart
Rutgers University

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Sponsoring Editor: Denise Clinton
Development Editor: Karla Paschkis
Project Editor: Susan Westendorf
Design Manager: Pat Mahtani
Art Editor: Caroline Ryan
Cover Designer: Mark Caleb
Manufacturing Coordinator: Priscilla J. Bailey
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Gift of Agnes Gund.

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Preface

THE FIRST EDITION OF THIS WORK was written in the mid 1970s, a period of stagflation, energy shocks, and general unease concerning the long-run future of market capitalism. Although planned socialist economies were experiencing their own troubles, the problems of capitalism appeared to be the most pressing. The second edition was written in the early 1980s, during the unexpectedly rapid reduction of the rate of inflation and the acceleration of economic growth in the West. The remarkable economic performance of Japan had become a topic of everyday conversation. These situations seemed to highlight the declining economic fortunes of parts of the East. Although talk of meaningful economic reform continued in the East, only the Chinese reform appeared to be yielding real benefits.

The third edition of this text was written in 1988. The mid to late 1980s was an era of conservative economic policy in the West. In virtually all major industrialized capitalist countries, conservative governments had come to power to pursue policies of privatization and to reduce the scope of government. Japan continued to be the envy of the West with its strong currency, rapid growth, low unemployment, and positive trade balances. The "four tigers" of Asia (Taiwan, Singapore, South Korea, and Hong Kong) gained strong footholds in world manufacturing and threatened to one day replace Japan. The major economic story of the late 1980s was the East's decision to attempt serious reform of planned socialism. It was much too early to know whether these attempts, spearheaded by the Soviet General Secretary Gorbachev, would lead to lasting change of the planned socialist economic systems. When we wrote the third edition we needed to wait for subsequent editions to answer this question.

Although much has happened since we prepared the third edition, in a real sense we must still await the outcome of ongoing changes in socialist economies.

The preparation of this fourth edition has been a challenge of major proportions. While all of the traditional problems of writing such a book in the field of comparative economic systems remained, the field itself was (and still is) undergoing change spurred in large part by sudden and dramatic adjustments in the socialist world. In light of these sweeping changes, our text has changed too: the combined descriptive and analytic approach that has been popular from the first edition has been refined and improved. We now divide the text into six parts. In Part I we set up the analytic framework that is applied throughout the text, including a new chapter on issues of transition and reform. In Parts II and III we focus on economic systems in theory and in practice,

respectively. Part IV focuses on interrelationships and performance of economic systems. We analyze socialist economies in transition in Part V and in Part VI theorize on future prospects.

In a sense, comparative economic systems has never been as challenging or exciting as it is in this era of transformation. Changes in the socialist world have opened up whole new avenues of research as information that had been hidden became available; at the same time, the Pacific Rim and other areas of the world have gained economic prominence, further enriching the field. In response to these shifts, we have added five new chapters: Chapter 1, Economic Systems in an Era of Change, Chapter 4, Economic Reform: Capitalism and Socialism, Chapter 16, Perestroika: The Soviet Reform Experience, Chapter 17, China: Socialism, Planning, and Development, and Chapter 18, Eastern Europe: Socialism in Transition. And all existing material was extensively revised. We have preserved our analytic framework that helps students define, describe, and compare various economic systems, even during these times of rapid and significant change. We have also expanded the Instructor's Resource Manual, adding and updating chapter introductions, test questions, case studies, and references. We hope the new chapters and new material in this edition convey the scope and excitement of comparative economic systems today.

Throughout the various editions we have relied upon a number of colleagues for helpful comments. We especially wish to thank Frank Holzman of Tufts University, Fred Zapp and Irwin Collier of the University of Houston, Gertrude Schroeder-Greenslade of the University of Virginia, Marvin Jackson of Arizona State University, Roger Morefield of the University of St. Thomas, Jan Svejnár of the University of Pittsburgh, Ira Gang of Rutgers University, and Gary Beling of Princeton University.

In the preparation of the fourth edition, we have also received review comments from a number of referees. We want to thank Gordon Bergsten of Dickinson College, Giulio Gallarotti of Wesleyan University, Leonard Kloft of the Miami University of Ohio, Susan Linz of Michigan State University, Edward Merkel of Troy State University, Roger Morefield of the University of St. Thomas, Michael Murphy of Tufts University, Dominick Perello of the California Polytechnic State University, Richard Pomfret of Simon Fraser University, Ronald Soligo of Rice University, and David Wishart of Wittenberg University. Their efforts have been greatly appreciated. Finally, as the readers of this work will appreciate, it is difficult to write a definitive work as the subject at hand changes on a daily basis. The staff at Houghton Mifflin, and especially Sponsoring Editor Denise Clinton, Development Editor Karla Paschkis, and Project Editor Susan Westendorf, have been most understanding of these circumstances. While accepting responsibility for the outcome, we thank those who helped along the way.

P.R.G.
R.C.S.

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PART

ECONOMIC SYSTEMS: ISSUES, DEFINITION, COMPARISONS

- 1. Economic Systems in an Era of Change**
- 2. Definition and Classification**
- 3. Evaluation of Economic Outcomes**
- 4. Economic Reform: Capitalism and Socialism**

1

Economic Systems in an Era of Change

THE FIELD OF COMPARATIVE ECONOMIC SYSTEMS has traditionally focused on comparing various countries that rely on different economic systems or organizational arrangements for the allocation of resources. Interest has centered on how to isolate such systems from other forces that affect the use of resources in order to understand how differences among economic systems influence economic outcomes. The obvious implication has been that some systems or system components might be found to be “better” than others — that is, more effective for achieving such national economic objectives as economic growth and consumer well-being.

It has always been difficult to classify economic systems — and especially to relate the differences among them to variations in performance. However, it has been convenient to think of systems in terms of basic and important characteristics, such as ownership (private or other) and decision-making mechanisms (free market or central plan). Thus we usually visualize a spectrum of systems ranging from market capitalism to centrally planned socialism, with various types of mixed arrangements lying between. Such a characterization has been useful for comparing the Western industrialized market economies with the planned socialist systems of the Soviet Union and Eastern Europe. Although systems change over time, the socialist-capitalist framework of comparison has until recently proved able to accommodate the modest changes taking place in socialist systems. However, since the advent of major political changes in the Soviet Union in 1985, unprecedented systemic changes have been taking place in the USSR and in many of the formerly planned socialist systems of Eastern Europe.

ECONOMIC SYSTEMS IN A NEW ERA

Although the roots of the rapid changes now under way reach back to the 1980s and earlier, the 1990s ushered in a new world order. The dramatic and aston-

ishing events of 1990 and 1991 — the ending of the cold war, German reunification, the fall of the communist governments in Eastern Europe, and the failed coup attempt in the Soviet Union — caught most observers off guard. The 1990s promise to be a decade of uncertainty as the new world order unfolds and seeks a new equilibrium. For the analyst of different economic systems, traditional models and approaches must be questioned; they may not be appropriate for tracking change deeper and more rapid than could have been imagined just 10 years ago. Even so, a number of critical issues must be addressed and resolved during the decade of the 1990s. How these major issues are resolved will determine the shape of the next century and the way in which different economic systems contribute to the resolution of critical economic problems.

1. Will the Soviet Union and its former Eastern Europe satellites succeed in transforming themselves into viable economies based on market allocation and non-state ownership? Will the economic decline of this region be reversed and the peoples involved gain access to a standard of living consistent with the resource base?
2. Will the Soviet Union and Eastern Europe become full-fledged members of the world economic community, opening up new product and technology markets for themselves and for their Western partners?
3. Will the Chinese embark on renewed economic and political reforms to rejuvenate their economy after the setbacks to reform that occurred in the late 1980s?
4. Will Western Europe and North America continue to move toward unification of world markets at the expense of national sovereignty? How will the industrialized West accommodate the desire of Eastern Europe to become part of this unification process?
5. Will the developing economies of Latin America, Asia, and Africa begin to make economic progress relative to the more industrialized countries of the world so that prosperity will cease to be limited to a small fraction of the world's population?
6. To what degree and in what ways will the new political and economic arrangements generate economic progress in the face of critical constraints such as energy requirements and the need to curtail environmental decay?

THE COMMUNIST WORLD

The year 1985 marked the starting point for serious change in the communist bloc.¹ In this year, the newly selected general secretary of the Soviet Communist party, President Mikhail Gorbachev, announced his intention to initiate "radical" reform of the Soviet political structure, society, and economy. Up until this point, the Soviet Union had been the most important example of a centrally planned socialist economic system that was experiencing serious problems in economic performance but had limited interest in economic reform. Gorbachev's call for radical reform was initially greeted with considerable skep-

ticism. After all, Gorbachev was an *apparatchik* — a person who rose through the party ranks and therefore could be expected to cling to past goals and methods. Few observers in 1985 could anticipate that five years later, Mikhail Gorbachev would receive the Nobel Peace Prize for his bold reforms, especially those related to Eastern Europe and the field of foreign policy.

As the new Soviet leadership introduced one reform after another, even the most skeptical of observers came to see that real changes were taking place. Thus, in spite of some discrepancies between the rhetoric of reform and the reforms actually instituted, the terms *glasnost*, *democratization*, and *perestroika* entered the Western vocabulary. They colorfully represent the radical reforms designed to change the economic systems and political arrangements of the Soviet Union and its Eastern European allies. Indeed, the pace of political and social change was rapid. Open criticism of the regime was tolerated; curbs on freedom of speech and of the press were significantly reduced; national and republican parliaments, city councils, and even factory managers were elected. Mass emigration of disaffected Soviet minorities was allowed, foreign travel became easier, religious activities were encouraged, and Marxist–Leninist ideology was disavowed. Most significant from a political and potentially economic perspective, the constitutionally guaranteed “leading role” of the Communist party became the subject of open discussion and debate. Indeed political dominance of the Soviet Union by the Communist party would end in the summer of 1991.

The immediate international consequences of liberalization in the Soviet Union were far-reaching. The lack of Soviet sympathy for conservative communist regimes in Eastern Europe became apparent. Soviet tanks would no longer be used to prop up unpopular dictatorships. Caught in the pincers of liberal reform in the Soviet Union and the attraction of consumer affluence in Western Europe, former communist dictatorships tumbled one after the other. As neighboring communist regimes granted access through their territories, East German citizens fled to West Germany, threatening to depopulate the former German Democratic Republic. The Berlin Wall was opened in November of 1989 and subsequently dismantled. The émigrés’ “voting with their feet” became so pronounced that the unpopular regime of Erich Honecker fell in November of 1989, to be replaced by that of Lothar De Maiziere, the last leader of East Germany before full reunification in 1990.

The overthrow of the East German communist regime was followed by a series of mostly bloodless revolutions in Eastern and central Europe. By the end of 1989, the Communist political structure in Czechoslovakia (the Czech and Slovak Federal Republic) was toppled, as Vaclav Havel was elected president and Alexander Dubcek speaker of the parliament. Free popular elections held in 1990 sustained the mandate of Havel and his Civic Reform party. In Bulgaria, the Communist leader Todor Zhivkov was replaced in November of 1989. Finally, in the spring and summer of 1990, elections left a majority of communists in the Bulgarian parliament but resulted in the naming of a new president, Zhelyu Zhelev, a non-communist. In Hungary similar events unfolded. In the fall of 1989, agreement was reached on the creation of a multi-

party system and on free elections to be held in 1990. In the spring of 1990, after elections were held, The United Democratic Front (a party in opposition to the reconstituted former Communist party) won, and Jozef Antall became prime minister. Events in Poland had generally anticipated those elsewhere. With the rise of Solidarity to political power in the summer of 1989, Tadeusz Mazowiecki became prime minister and General Wojciech Jaruzelski president. These arrangements were, short-lived, however. In September of 1989, General Jaruzelski announced that he would step down, a move that led to the election of Lech Walesa, who replaced Tadeusz Mazowiecki as the Polish leader. Finally, the despotic dictator of Romania, Nicolae Ceausescu, was executed in a bloody uprising. By the summer of 1990, elections placed Ion Ilies in the position of president, though unrest continues.

The process of political change in Eastern Europe typically followed a two-step pattern. First, the unpopular totalitarian communist regime was replaced by reform-minded communists, who formed coalition governments with non-communists. In this phase, the Communist party's monopoly on political power was broken. In the second stage, a non-communist coalition government was elected on a platform of closer alliance with the West and the establishment of a market economy. *Economic disarray resulting in popular discontent and the withdrawal of Soviet backing were two major forces that led to these developments.*

Events in China were equally dramatic, but they had quite different results. In the early 1980s, the aging Chinese communist leadership seemed determined to open the country to the West and to reform the Chinese planned economic system. The reintroduction of private incentives in agriculture and the initial influx of foreign investment boosted economic growth and brought about substantial improvements in living standards. However, liberalization quickly spilled over into political and social life. When, in the spring of 1989, opposition groups began to demand fundamental changes — an end to the Communist party monopoly, free speech, and democratic elections — the communist regime decided to crack down on the reform movement. This decision culminated in the May 1989 Tiananmen Square massacre, the arrest of leading dissidents, and the introduction of sanctions by Western governments against the Chinese regime.

The Chinese retreat to conservatism was in stark contrast to developments in the Soviet Union and Eastern Europe. Although the process of effecting economic reform in the Soviet Union has proved difficult, in Eastern Europe there was general acceptance of the long-term goals of reform: establishment of a market economy, multi-party elections, and free speech. In China there was instead a marked retrenchment in favor of traditional communist ideals: a slowing of economic reform and a return to dogmatic one-party rule. Little of substance had changed in the China of 1990, and many suggested that only the demise of an aged leadership could revive the prospects for political reform and the resumption of real economic changes.

By the start of the 1990s, conservative communist regimes were to be found only in China, Cuba, and Albania. And in 1990, the Albanian president Ramiz Alia responded to demonstrations with some concessions. Also, the Asian

communist countries, Vietnam and North Korea, took preliminary steps toward reform and reconciliation with their archenemies in the West (the United States and South Korea).

From our brief survey of recent events in the formerly socialist world, it is evident that **economic change must follow political reform**. However, the reforms that have taken place in the Soviet Union and in Eastern Europe have already demonstrated that **political and social reform are easier to achieve than fundamental economic reform** — that is, moving from a socialist command economy to a market economy. The communist world does not yet know how to dismantle the command economic system, which in many quarters is now derisively labeled the “administrative-command economy.” Moreover, although consensus exists that market allocation based on private ownership should be one of the long-term goals of general economic reform, no one appears to know the formula for a successful transition from the administrative-command economy to the market economy. As we have noted, analysts of differing economic systems have tended to think in terms of system models such as market capitalism and centrally planned socialism. Real-world variants and issues of systemic change have been widely discussed, but much less attention has been paid to *transition* from one system to another, and especially to the sorts of policies that might be useful in a period of transition. These are critical issues for the contemporary analyst of different economic systems, because for the most part, political change has already taken place in the countries of Eastern Europe, and economic change (in varying stages) is still in progress. As we shall see, Poland, Hungary, and Czechoslovakia are leading the way in systemic change, and the eastern part of Germany is another fascinating, rather special case. In the Soviet case, fundamental political change has been recent (1991) leaving radical economic reform to be explored at the republic level under new decentralized arrangements.

THE INDUSTRIALIZED WEST

In the past, we have been accustomed to thinking of economic reform or change in socialist systems as center-directed and sporadic, and of change in market systems as decentralized and ongoing. Although change was less dramatic in the industrialized West, change did occur in the 1980s, and remarkable events are slated for the 1990s as well.

With few exceptions, the 1980s witnessed voter repudiation of the more extreme forms of social democracy. The 1980s were dominated by Reaganism in the United States and by Thatcherism in England — both movements designed, at least in theory, to replace the ills of “big government” with the benefits of the market. In Germany, the conservative Christian Democratic party strengthened its hold over German politics at the expense of the waning Social Democratic and Environmentalist (Greens) parties. Western conservatism put into motion policies designed to reduce the role of government in the economy and to shift existing government functions from federal to state and