Market Reforms in Socialist Societies

Comparing China and Hungary

edited by
Peter Van Ness

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In memory of
György Ránki and Satish Raichur—
colleagues, scholars, and
friends

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Peter Van Ness

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Introduction

Peter Van Ness

This book is a comparative study of the process of dismantling the Soviet-type command economy in China and Hungary, and the problems of implementing a market mechanism in its place. The two countries are in a critical transformation phase, no longer command economies but not yet market systems. The future they want to avoid is the present situation in Yugoslavia. Still in transition after forty years of market reforms, Yugoslavia is suffering its worst economic crisis in the postwar period (inflation averaging 217% annually in late 1988, high unemployment, and an estimated $21 billion foreign debt) and unprecedented political protests prompted at least in part by the economic crisis.

The studies in this book focus on this critical phase of transition, from which no socialist country has yet emerged. The problems of the command economy are clear and sufficiently serious to have prompted ruling communist parties to attempt market reforms, but the future is by no means certain even if market economies can be successfully introduced. What communist-party states lack is a political process capable of fully implementing market reforms. Hungary has been reforming on and off for twenty years, and China for ten—but Yugoslavia after forty years of reform still does not have an operational market system in place.

My objective in this introduction is to set an agenda for the book—that is, to raise some of the central questions about market reforms in socialist societies and to suggest a conceptual perspective for addressing them in our case studies of China and Hungary. Why have communist governments introduced market reforms in their socialist societies, and what specifically are they trying to achieve? What problems do they expect the market to help them solve, and how? How successful have they been? What are the implications of adopting this approach to socialist development for the Marxist objective of reaching communism?

These are paradoxical times. During late October and early November 1987, as the world capitalist stock markets suffered their worst crash in history,[1] the leaders of the two most important socialist countries, China and the Soviet Union, reaffirmed their commitment to use market reforms to revitalize their socialist command economies.[2] In fact, virtually every ruling communist party in Asia and Eastern Europe either has considered adopting market mechanism reforms for its socialist command economy or has already begun to implement them. Yugoslavia was first, then Hungary, China, and now the Soviet Union. But why should communists in power choose to reform their economies by utilizing the basic structural feature of the capitalist system, the market? Doesn't this mean, as a result, that they are inevitably "going capitalist"?

If there was ever a subject that required a political economy approach for analysis, this is it. Politics and economics are inextricably intertwined in this phenomenon of market reforms in socialist societies. The question, however, remains which political economy? What conceptual approach or paradigm would be most analytically useful? How significant are these reforms? Some accounts describe China and Hungary as headed for capitalism, but other analysts point to what they see as the "totalitarian" character of communist-party states and note that so far none of these regimes has ever been successfully reformed.

One feature that communist-party states generally have in common is a Soviet-style command economy—a planned economic system that operates on the basis of output quotas set by the state rather than a market responsive to supply and demand. This is a part of their Stalinist heritage.[3] The majority of the world's ruling communist parties came to power (either by making their own revolution as China did, or with the help of the Soviet Red Army as in the case of Hungary) during the period of Stalin's rule in the Soviet Union. Stalin insisted that "socialist construction" for communists in power meant, among other things, adopting the Soviet system as a model and building a command economy.[4]

Despite staggering human costs, the Soviet-style command economy was initially successful in the Soviet Union and in China as a method for building an industrial infrastructure in what were basically nonindustrialized societies.[5] Command economies at later stages of development, however, seem inevitably to suffer from problems of declining rates of growth in productivity (especially in comparison with the more dynamic industrialized countries of the West and East Asia) that apparently cannot be resolved within the central design features of the system.[6] Mikhail Gorbachev in his analysis of these problems in the Soviet Union concludes:

> We first discovered a slowing economic growth. In the last fifteen years the national income growth rates had declined by more than a half and by the beginning of the eighties had fallen to a level close to economic stagnation. A country [the USSR] that was once quickly closing on the world's advanced nations began to lose one position after another. Moreover, the gap in the efficiency of production, quality of products, scientific and technological development, the production of advanced

technology and the use of advanced techniques began to widen, and not to our advantage.[7]

The purpose of employing the market as an instrument of reform in a command economy is to force competition and thereby to enhance efficiency. Because of the inefficiencies of centralized state planning and the priority placed on achieving rigid output quotas that characterize the command economy, such systems do not produce what is needed and desired by consumers, and they stifle both workers' enthusiasm and managerial initiative. Thus, one intended function of market mechanism reforms in a socialist command economy is to establish a direct link between the quality and quantity of what workers and enterprises produce and the material benefits they receive in return, thereby increasing productivity.

Clearly, however, market reforms in socialist societies are controversial. In the debate over the reforms in the different communist-party states, one can identify three distinct positions with respect to their assessment of the classical Stalinist-model socialist society (i.e., a social system combining a command economy and a so-called dictatorship of the proletariat). They are the conservatives, the reformers, and the radicals. Each position entails linking politics and economics in a distinctive way.[8]

The conservative position is the orthodox view. Conservatives, often older party leaders who are veterans of the struggle for power and who typically might have responsibilities in the military or public security organs, defend the party's monopoly of political power and the economic control maintained by the planning bureaucracy as hallmarks of what it means to be a socialist society. They cite ideological chapter and verse from Lenin (and sometimes even from Stalin and Mao) to defend their position, and point to the achievements of ruling communist parties since the Soviet Communists first won power in 1917. Although they might agree to a minor role for the market in a socialist society, the conservatives generally see systemic market reforms as a "capitalist" heresy, one that contains the danger of undermining party control and reversing progress already achieved on the road to communism.[9]

Reformers, by contrast, point to the inefficiencies that have become apparent in the command economy and argue that the best way to restore vitality and initiative to socialist societies in an increasingly competitive global environment is to introduce systemic market reforms. Moreover, they postulate that the prerequisite to socialist construction is a more substantial economic foundation (more developed "forces of production") and argue that unless sustained and substantial economic growth is achieved, communism must continually be postponed.[10] The reformers attempt to justify their initiatives in terms of Marxist ideology, even when their reform policies are designed to operate in terms of a logic borrowed from Western neoclassical economics.

Finally, many (but not all) of the radicals reject Marxism as a philosophical orthodoxy for determining the future of socialist societies. The most prominent radicals are former or even current party members. Most would probably agree with the outspoken radical, Chinese astrophysicist Fang Lizhi, who said in an interview, "Marxism is a thing of the past. It . . . belongs to a precise epoch of civilization which is over. It is like a worn dress that must be put aside."[11] The radical critique focuses on political change: the democratization of what Marxists call "dictatorship of the proletariat" and what the West tends to understand as "totalitarianism."[12] Radicals argue that the market reforms can never be successful without a basic political transformation. Their principal target is the party's monopoly of political power.[13]

To summarize the basic differences among the three positions, *the conservatives* want to keep the Soviet-type system fundamentally intact (a little market reform perhaps, but nothing that would change the fundamentals of the system); *the reformers* want to change the operation of the economy in order to make it more efficient, while preserving the party's monopoly of political power and continuing to proclaim loyalty to Marxism; and *the radicals* want to throw out the entire Soviet-type social system, politics as well as economics, and begin with a democratization of the dictatorship of the proletariat.[14]

Not every one of the participants in the reform debates fits precisely into one of these categories, but these generally are the main positions represented. To cite examples from China in 1987 just before the 13th Party Congress, veteran Politburo Standing Committee member Chen Yun and National People's Congress Standing Committee chairman Peng Zhen represented the conservative position; Deng Xiaoping and his protégé, Premier Zhao Ziyang, were prototypical reformers; and the jailed dissident Wei Jingsheng and astrophysicist Fang Lizhi were two of the most prominent Chinese radicals.[15] The 13th Party Congress was a resounding victory for the reform position, especially when four key conservatives (Chen Yun, Peng Zhen, and ideologues Hu Qiaomu and Deng Liqun) were retired from their top party jobs.

The studies collected in this volume primarily reflect the reform position. Some authors are reform leaders; others are academic proponents of reform. However, alternative positions are also represented. For example, Su Shaozhi, who presents in Chapter 9 a commentary on the Hungarian reforms as seen from a Chinese perspective, was sacked in 1987 as director of the Institute of Marxism–Leninism–Mao Zedong Thought because of his allegedly radical, "bourgeois liberal" views.

This book attempts to evaluate the present status of market reforms in socialist command economies by focusing on a comparison of China and Hungary. It is a collection of assessments by Chinese and Hungarian scholars of their own and each other's problems and achievements, plus commentaries by U.S. specialists. The project was begun as a conference held at the University of Denver in 1985. Subsequently, all of the papers were revised for publication, and several additional chapters were commissioned to complete the analysis.

Comparing China and Hungary

China and Hungary are at present pioneering these fundamental structural changes in the command economy, and the Soviet Union under Mikhail Gorbachev has now begun to follow suit. All other communist-party states see that their futures are also at stake in this ambitious experiment. Moreover, other than Yugoslavia, China and Hungary are the two socialist countries in which market mechanism reforms have been most fully implemented. Although Yugoslavia was the first communist-party state to undertake market reforms, in the three years between the party's revolutionary victory at the the end of World War II and Tito's break with Stalin in 1948, Yugoslavia never fully established a command economy on the Soviet model. Yugoslavia's experience, therefore, is not really comparable with the other communist-party states in this respect.

Yet, one might well ask what benefit there can be from an effort to compare China and Hungary, two countries that are different in so many ways: in their history and cultural tradition, geographical location, population and resource endowment, degree of industrialization, general standard of living, communist road to power, and degree of autonomy and extent of global influence. China is a large (the world's largest in population, third largest in land area), resource-rich, energy-exporting, low-income country. In contrast, Hungary is a small (only one-hundredth China's population), resource-poor, energy-importing, upper-middle-income country.[16]

In short, China and Hungary are different in virtually every way but one. They have a similar social system comprised of a Leninist communist-party state and a Soviet-type command economy, and as a result, despite their many differences, China and Hungary face many of the same kinds of economic and political problems.

When communist parties came to power in the two countries in the late 1940s (albeit under very different circumstances), they set up Soviet-type centrally planned economies as part of a close economic and political relationship with Stalin's Soviet Union. The problems that the market-mechanism reforms are designed to treat derive from that legacy, and in this sense, the problems that Hungary and China have experienced are representative of a common set of serious difficulties faced by the entire communist world. Similarly, their solutions, the market reforms, may provide answers that are widely applicable outside the two countries.

The rest of the communist world is observing the progress of those reforms most attentively, with an eye to emulating part or all of what Hungary and China have attempted in their own socialist systems. No matter what the outcome, their success or failure will have a significant theoretical and practical influence on the future of socialism. Market reforms are the most important structural changes in the Soviet-type social system that have been attempted since Stalin's death in 1953.

The phenomenon we are investigating is often referred to as "market socialism," and for lack of a better alternative, we will also use this shorthand term.[17] But isn't *market socialism* a contradiction in terms? Socialism by some Marxian definitions should be a society without commodity production and, instead, with allocation by plan—a long-term objective of socialism being to do away completely with the market. On the other hand, the market is the central feature of a capitalist economy—the "invisible hand" that almost magically is supposed to link supply and demand. So how then can *market* and *socialism* be combined?

Upon empirical investigation, one finds that all modern economies are some combination of both plan and market. Moreover, there are several different kinds of markets (e.g., markets for consumer goods, capital equipment and technology, labor, and equities), and one or more kinds operate in all contemporary societies. Thus, a kind of market socialism is a fact of life in all contemporary socialist societies (just as, one might say, a kind of planned capitalism is a fact of life in all contemporary capitalist societies). In this sense, "market socialism" is not a contradiction in terms.

For the purpose of this study, we define market socialism as a development strategy undertaken by a ruling communist party that employs a market mechanism to effect systemic change in an existing command economy. This definition is not as restrictive as some. For example, János Kornai has written: "The idea of market socialism is associated with the expectation that the 'marketization' of the socialist economy creates equilibrium of supply and demand. It is a crucial litmus test of reform to see whether such equilibrium has been established."[18] In other words, for Kornai, the implementation of market reforms in a socialist economy must have reached the point at which an equilibrium of supply and demand has been created before that system could properly be labeled "market socialist." The definition used in this volume, however, is not so demanding. By "market socialism" we simply mean a strategy for development in a command economy that is designed to bring about basic change in that economic system by employing market-mechanism reforms. This definition focuses on the demonstrated policy intentions of a ruling communist party, not (like Kornai's) on how successful those policies have been in transforming the command economy.

It should be noted that each economic system operates on the basis of a particular logic, usually either a market logic or a plan logic with the other aspect of the system playing a secondary role. The United States, for example, has essentially a market economy, but one that is shaped by various kinds of planned governmental interventions to constrain market forces (e.g., to minimize the adverse effects of recession and inflation). China and Hungary are the opposite: They have basically planned economies with an increasing role permitted to market forces under the control of the plan. For example, the current slogan in China is "the state regulates the market, and the market guides enterprises."[19]

But does this mean that when a ruling communist party attempts to use the market to reform its command economy that the country is inevitably "going capitalist"? The answer to this question obviously depends on what one means by "capitalism"—what definition and criteria are applied. If, for example, "taking the capitalist road" is defined as Mao Zedong specified it during the Cultural Revolution (1966–1976) in China, then, *yes*, China and Hungary are indeed going capitalist. For Mao, party policies that, for example, permit foreign investment and private enterprise, emphasize individualized material incentives, decollectivize agriculture, and generally enhance the role of the market definitely constitute "taking the capitalist road" rather than building socialism.[20]

If, instead, the existing social systems of the United States, Japan, and Western Europe define "capitalism" for the purpose of answering this question and one puts the question from the perspective of Western neoclassical economics, then the answer is *no*. To achieve a market economy in the Western sense would require political reforms that would change the nature of the "dictatorship of the proletariat" and undermine the party's monopoly of political power—something that no ruling communist party so far has been prepared to do.

Thus, so-called political reforms are at the heart of the matter. Certain fundamental changes in the communist-party state system might indeed facilitate the development of capitalism. But the Deng Xiaoping leadership in China, for example, has insisted on maintaining what it calls the *four fundamental principles*: "upholding the socialist road, the peoples's democratic dictatorship [i.e., the dictatorship of the proletariat], the leadership of the Communist Party, and Marxism-Leninism and Mao Zedong Thought."[21]

Conceptual Approach

This collection of essays is an analysis of similarities—what China and Hungary have in common. It is an examination of the Stalinist command economy and market-mechanism strategies for reform in the two countries.

No existing paradigm or intellectual perspective seems satisfactory to grasp the fullness of what is happening in countries like China and Hungary today. Analysts typically employ either the conceptual perspective of Marxist political economy or Western neoclassical economics. Both are represented in this volume. Each has obvious analytical utility, but both paradigms also have their blind spots.[22] Unfortunately, they cannot be combined successfully because the two paradigms are based on different assumptions, designed to answer different questions, and constructed out of incompatible theories.

There is a deep crisis in Marxist theory at present, both with respect to employing the Marxist paradigm to comprehend what is happening in capitalist societies and especially with regard to understanding how socialist societies might best be reformed. The ideological justifications for market socialism put forward by party leaders and propagandists are by and large rationalizations for pragmatic change rather than serious theoretical arguments, because, generally speaking, a reintroduction of a market mechanism into a socialist economy cannot be justified in Marxist theory short of admitting a complete bankruptcy of party leadership in the earlier stages of development, or accepting that the ultimate objective of communism is utopian.

The Chinese Communist Party has opted for an argument that China is still in the "primary stage of socialism" that will last into the middle of the next century (an important change from being well on the way to achieving communism, as Mao had claimed during the Great Leap Forward in 1958)[23] and that the principal task at present is to build up sufficient "forces of production" ultimately to sustain the material requirements of communism.[24] The obvious contradiction between using capitalist means to achieve supposedly communist objectives is not addressed. As economists in China and Hungary have focused increasingly on analyzing the operation of markets in their socialist societies, they have, perhaps inevitably, shifted their frame of reference from Marxian political economy to neoclassical economics.

Market reforms in socialist societies will presumably at some point produce a new paradigm—that is, a whole new way of understanding contemporary socialism (and probably capitalism as well). Unfortunately, we are not there yet, so this unavoidably must be a progress report.[25] In my judgment, five studies in the general literature best help to set the agenda. Each illuminates a key dimension of the phenomenon.

The five are books by Ota Sik, Milovan Djilas, Charles Lindblom, and Alec Nove, plus the debate between Christopher Chase-Dunn and Albert Szymanski in *Socialist States in the World-System*. To my mind, their work represents some of the most promising paths of intellectual inquiry for analyzing market reforms in socialist societies. Taken together, they provide a framework for integrating the fourteen chapters that comprise this volume.

The best-argued theoretical case by a Marxist economist for precisely why and how a market mechanism should be incorporated into a socialist planned economy is a 1967 book, *Plan and Market Under Socialism*, by the Czech economist Ota Sik. Although labeled a "naive reformer" twenty years later for failing to foresee the great practical difficulties of combining market and plan,[26] Ota Sik in this early book nonetheless spelled out in clear and concrete terms the nature of the economic problem for command economies and the logic of the market mechanism solution.[27]

A party planner and economic theorist of the "Prague Spring" reforms in Czechoslovakia in 1968 (before they were snuffed out by the Warsaw Pact military intervention), Sik focuses his criticism on the shortcomings of the command economy, which is characterized by (1) public ownership of the "means of production," generally meaning state ownership of industry and collective ownership of land and agricultural equipment, and (2) centrally planned, bureaucratic coordination of the economy. The planning bureaucracy exerts institutionalized, vertical control over the state-owned sector of the economy through a multilevel hierarchy that sets output targets and input quotas, allocates labor and investment, and appoints managers of state-owned firms. The bureaucracy controls the collective economy by establishing quotas for compulsory sales to the state (of grain and cotton, for example) and by setting the prices of key commodities.[28] Among other purposes, the command economy was designed to do away with the evils identified by Marx as inherent in a capitalist, market economy (e.g., class domination through ownership of the means of production, capitalist exploitation of hired labor, and worker alienation) and to establish a process for achieving communism.

The economic problems produced by the command economy are a declining rate of growth in productivity; a stifling of managerial initiative and worker enthusiasm at the production unit level; an economic sector imbalance (typically in favor of heavy industry and at the expense of light industry); and a failure to meet consumer demand. Even when assisted by sophisticated computers, party planners have not been able to anticipate demand as well as a market, and the command economy has characteristically not produced goods of a quantity and quality desired by consumers. (See Chapter 2 by György Ránki.)

Ota Sik's 1967 book laid out a theoretical design for employing a market mechanism to reform the classicial command economy. Permitting a greater role for the market would force production units to compete and would reward the more efficient with direct, material incentives. A decentralization of power from the bureaucracy to enterprise managers would carry with it the requirement that firms now would be responsible for their own profits and losses. Managers and workers who did more and better work would reap the rewards of higher salaries and bonuses.

In addition, a modest private sector would be permitted to develop, and collective enterprises would be encouraged—both potentially in competition with state-owned firms (although they were usually in different industries). As the economy was increasingly shaped by the market forces of supply and demand rather than rigid quotas set by the central plan, imaginative entrepreneurs would be rewarded with higher profits, and consumers would enjoy a wider selection of consumer goods. The overall economy would benefit from increases in productivity.

Market socialism for communist-party states has also meant opening their economies to the West, seeking foreign capital and technology by inviting foreign investment and participating in international financial institutions like the International Monetary Fund and the World Bank. In addition, China, for example, has established a major foreign tourist industry in order to earn hard currency income, and Beijing has sent thousands of Chinese scholars and students abroad for advanced training. For Ota Sik, one of the benefits of expanding an export trade with the West is that successful competition in the global market should increase the standards of product quality for domestic production as well.

In practice, market reforms have not been as easy to implement as Ota Sik suggested they might be in his theoretical discussion. Party conservatives especially balk when initial reforms begin to produce inflation, contribute to unemployment problems, and result in budget and foreign trade deficits. The key problem, however, seems to be political: Will the bureaucracy be willing to give up enough power to allow the market to function—in Kornai's terms, so that "the 'marketization' of the socialist economy creates equilibrium of supply and demand."[29] Thus far, the communist parties of China and Hungary have not been willing to go that far.

Whereas the reformers want to use the market to remedy the inefficiencies of the command economy but keep party political power intact, the radicals go much further. They would like to use market reforms to erode and ultimately to destroy the party's monopoly of political power. As one Yugoslav scholar put it, the central objective of reform is political, not economic. At issue is the Communist-party state. (See Chapter 5 by George Barany.)

An early Marxist critique by the Yugoslav dissident Milovan Djilas is still, in my opinion, one of the most penetrating commentaries on the communist-party state. Djilas's *The New Class*, first published in English in 1957, argues that the communist bureaucracy in contemporary socialist societies has become a new ruling class. Citing Marx's argument that the dominant class in any society is the group that owns the principal means of production, Djilas turns Marxian analysis against communists in power, asserting that because of its control over the publicly owned means of production, the communist bureaucracy in socialist countries has become the ruling social class. He writes: "Property is legally considered social and national property. But, in actuality, a single group manages it in its own interest."[30]

Djilas observes that successful communist revolutions did not occur in the most developed capitalist countries as Marx had expected, but rather in countries (like Russia, China, and Yugoslavia) where for a variety of reasons capitalism had failed to take hold. The historical task of communists in power became to carry out a forced industrialization of underdeveloped societies. The Soviet-type social system that Stalin created in the Soviet Union, ruled by a communist party ("the backbone of the entire political, economic, and ideological activity" of the society), became the prototype, the model: "Lenin's dictatorship was strict, but Stalin's dictatorship became totalitarian."[31]

If Djilas is indeed correct that the foundation of communist party power resides in its control over a publicly owned economy, then market reforms calling for changes in ownership and the freeing of economic activity from bureaucratic control have important implications for the party's monopoly of political power. Analysts have long observed that "totalitarian" systems are very resistant to change, and never has party power in a Soviet-type social system been successfully challenged. Perhaps in the market, radicals have found an answer.

From a different analytical perspective, Charles Lindblom seems to confirm