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Abasov, Muzaffar

Middle East Technical University

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MIDDLE EAST TECHNICAL UNIVERSITY

DEPARTMENT OF ECONOMICS

COMPARISON OF CHINESE REFORM EXPERIENCE WITH
OTHER TRANSITION ECONOMIES

(IN THE EXAMPLE OF RUSSIA)

BY

MUZAFFAR ABASOV

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Abstract

China and Russia were two most important communist countries of 20th century which decided to have transition towards a more liberal market economy. China followed a gradual reform strategy while Russia followed a rapid one. This paper analyses the reasons why China's transition experience was much more successful when compared to Russia. Paper concludes that initial conditions of the economies, the strategies chosen and some external factors such as political situation played important role in the outcome of the reforms.

Keywords: transition economies, reform strategies, Chinese economy, Russian economy

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1. INTRODUCTION

China and Soviet Union were two of the largest socialist, planned-economy systems during the 20th century. As a result of many years of struggle to maintain the communist system both decided to stop command economy regime and transform towards a liberal market economy in 1978 and 1991 relatively. This paper will compare the reform experiences of China and Russia as a representative of post-Soviet countries.

Soviet Union was a better example of a socialist system and planned economy when compared to China. It was established way before People's Republic of China and took significantly more time to give up on socialist ideology. But during their respective transition periods China followed a policy of gradual changes under the state control while Russia went for a more radical system change. These strategies can be called state-directed transition strategy (SDTS) and neoliberal transition strategy (NLTS) respectively. (David M. Kotz, 1999) China was significantly more successful than Russia and other post-Soviet Countries. This paper will analyse the reasons behind these differences in terms of development. How China could surpass Russia while being well behind it before reforms? Did the nature of strategies itself created the difference? Time of starting transition with different economic, political and social environments in and outside of the countries and the economic policies they followed will also be considered as possible reasons.

Several articles, books and papers have been written in this topic. An article by **Wing Thye Woo (1994)** analyses the reform experiences of China, Poland and Russia. He rationalizes the idea of gradual transition of China with the political deadlock of pre-reform period and concludes that China was more successful in the areas where she experienced radical reforms. **Jingjie Li (1994)** analyses the reform characteristics of Russia and China in her article and concludes that Russia made political reforms before the economics ones as opposite to China. She proposes that Communist party and other authorities being obstacles to the reforms was the reason behind it. **Michael Burawoy (1996)** in his paper examines the reasons why Russia has faced an economic decline while Chinese economy grew. He analyses the differences of the strategies chosen by two countries and highlights the problems with the implementation of strategies by Russia. **Trevor Buck, Igor Filatotchev, Peter Nolan and Mike Wright (2000)** in their research paper about reforms in China and Russia analyse the reasons behind the choice of different paths of transition and the consequences of these decisions. Paper proposes conclusions for policy, practise and future research. In his papers on comparing the economic reforms of Russia and China and analysing the role of state in transition **David M. Kotz (1999)**

and 2004) considers two strategies to be radically different and explains the reason of China's success to be a result of advantages of state directed transition. He derives important lessons to be considered in his first paper and in his second paper he concludes that China's policy in itself has a tendency from state directed towards a neoliberal transition strategy.

2. COMPARISON OF CHINESE REFORM EXPERIENCE WITH RUSSIA

It is widely accepted that China was more successful than Russia with its reform experience. There might be two possible reasons for this outcome. One of them is the initial condition of the economy when starting the reform period. The other one is the reform strategy chosen and its implementation. It can also be argued that the reform strategies chosen were also a result of the initial condition, therefore, pre-reform conditions were the most important factor. However, even if the initial conditions were favourable before the reform period, the situation during the reform period also plays an important role to determine the outcome.

This part of the paper will discuss and analyse the pre-reform and reform periods of China and Russia.

2.1. Pre-reform period situation in China and Russia

China and Russia has many things in common such as large geographical area, tremendous amount of natural resources, relatively cheaper labor force, attractive markets for foreigners. But they also had very different situations right before they started to implement transition policies.



Graph 1: Sectoral GDP of China between 1973 and 1977. Source: National Bureau of Statistics of China

Socialist era in China cannot be considered as a successful one at all. Problematic economic policies led to tragic results. Along with having a very non-stable but still growing economy, China was one of the poorest countries with a per capita GDP as low as \$185 in 1977 (China NBC). The average growth rate of the economy for last 5 years of socialist era was around 4.2% (China NBC) but standard deviation of growth rate was around 3.75% and it is high enough to call the economy non-stable. Non-

stability of the Chinese economy in all sectors for last 5 years of pre-reform period can be seen from Graph 1.

While by 1972 China re-established her relations with western world, during 1974-1976 country was hit by an insurmountable political situation which led to a paralysis in economic policy making.

Finally, in 1978 new economic reforms introduced and China entered to the reform period.

USSR on the other hand was experiencing a very difficult political situation during its last years and also trying to make gradual transformation to a less communist economy. However, economy in general was not a poor one as China was before reforms, even not comparable. USSR was second largest economy in the world after US in real terms and she had \$9,211 GDP per capita (CIA, 1990) and considering Russia was the main player of the union we can think that she had even higher GDPPC.

However, revolution attempts of member nations, wars between member countries and most importantly “diseased” and corrupted economy dragged USSR to collapse, Gorbachev’s attempts to make gradual reforms was also unsuccessful and all member countries including Russia entered their reform and transformation period.

2.2. Situation in China during collapse of USSR

USSR collapsed 23 years after China entered its reform period. When Russia and other post-soviet countries started their transition period China has already come a long way, increased its real GDP and GDP per capita more than 3 times.

In this period, China was entering to a new era of its reforms and modernization as discussed in 14th National Congress and the key goal of China for 1990s was to build a “socialist market economy” (People’s Daily Online, 2013).

2.3. Comparison of reform experiences

2.3.1. Discussion of reform strategies

China and Russia followed very different reform strategies. China’s strategy can be called state-directed transition strategy (SDTS) which was a gradual approach to reforms, while the path

Russia followed can be named neoliberal transition strategy (NLTS) and it can be characterized with radical reforms. (David M. Kotz, 1999) Some may argue that Russia also had some gradual policies towards a more liberal economy as during the last years of USSR Gorbachev was trying to implement some reforms such as establishment of some private entities.

China started its reform period in 1978 and the idea was to transform to market economy through gradual policies. China did not want to accept advises from western world and the idea of rapid transformation. Some may also argue that China's success in economic development was not because of but despite the strategy they have chosen. Chinese leaders considered this state-directed strategy to be a safer strategy. They did not change the political system and Communist party maintained its control, reform policies were to be made on economic system. Slow gradual changes would let them to carefully analyse the next step they would take without taking much risk. In other words, China decided thinking long term, but acting short term.

After Russia gained its independence with the collapse of USSR in 1991 the main purpose was to rapidly destroy the socialist system and build a liberal market economy. Although China's success with gradual reform strategy was already known, Russian government thought that the economy was too corrupted and problematic to be corrected with gradual changes and rapid changes would make a shock effect on the economic system. Russia considered the communist party and the state structure to be an obstacle to the economic reforms towards market economy and it was one of the main reasons why they run political reforms before economic reforms. (Li, 1994) However, the experience of China showed that it was also possible to transit keeping the current government structure with some changes. Russia mainly affected by western ideology and suggestions about abolishing communist government and implementing neoliberal, radical reforms. All the actions undertaken by the government were radical in nature. As one of the first steps, for example, Russia started to distribute industry firm vouchers to all citizens in order to rapidly withdraw the state from industry and privatize the economy. They intended to facilitate the control and ownership of companies by managers and employees, to establish "manager controlled, employee owned" firms in a very short period of time. (Earle and Estrin, 1996)

2.3.2. Economic, political and social situation and policies of Russia and China during reform periods

People in China were in such a bad situation with extreme poverty that they were welcome to accept new reforms. The reforms started with freeing prisoners of Cultural Revolution, letting

the millions of young people to return to cities who were forced to move to countryside. During the 1st phase of reform period in China which took place from 1978 to 1993 government pressure on agriculture has been loosened and the conditions has been changed to be beneficial for farmers. Lease of land to farmers started in a few years and became quite common all over the rural China. The power and resources gradually changed hands from central authorities to local actors. Markets introduced where possible. (Naughton 2007, 85-91.) In general, the reforms of 1980s were making everyone better off in the economy which means that the previous system in China was not efficient at all and market was not Pareto Optimal.

Dual track price system brought into the scene, commodities had a state-set lower price and a flexible market price. China did not introduce privatization of industry, instead managerial reforms were introduced. Competition in the economy created through new entrants and state monopoly got relaxed over industry. Flexible prices led to equated demand and supply. (Naughton 2007, 91 & 94.)

At the end of 1980s the political situation in the country again became serious. Rising inflation, corruption in the economy, non-existence of freedom of speech and press etc. led to protests by students and government silenced the protests.

Second phase of reforms started in 1993 and still continues. During 1990s government recentralized fiscal resources, market reunified, dual price system came to an end, privatization started, institutions of market economy strengthened. (Naughton 2007, 91.) Policies and reforms concerning tax, financial and banking system introduced. In the beginning of 21th century China accepted to WTO.

Unlike other post-socialist countries China did not introduce major political changes to its governance system. Communist government still continues to rule the country.

Russia was in a very difficult economic, political and social situation during the initial years of the reforms. Soviet Union did not collapse easily, during and after the collapse wars between and inside member countries and nationalist revolutions were taking place all over the post-soviet area including Russia itself. Russia was trying to control this situation and if possible to maintain its power on other post-soviet countries. Changing an economic and political system established during 70 years in a very short period of time is not easy.

According to Buck et al. (2000) people in general were not happy with the reform strategies. The main reason behind this was that the radical changes were creating strict problems in the economy such as very high inflation. Poverty was a very common problem.

As mentioned before, the system in last years of Soviet Union was very corrupted and it was not easy for Russia to get rid of this problem. Instead, the corruption and illegality was more likely to increase during radical economic and political changes. Crime rates were very high in the country starting from the early 1990s and number of crimes during 1993, 1994, 1995 were twice as many as 1991. (Clemens 2001, 106.) Rise of illegal gangs, almost non-existence of law, and extreme corruption lasted many years. (Bush 2006)

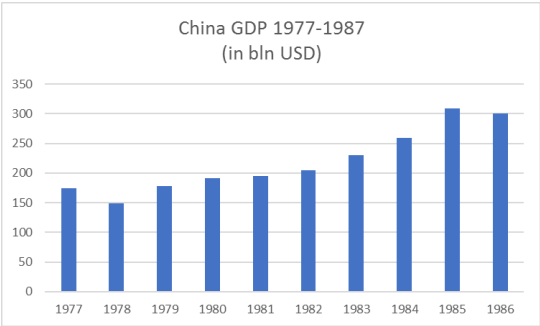
Russia changed its political system rapidly. Communist government was replaced by publicly elected president. New constitution has been introduced in 1993.

Privatization of enterprises started at the last years of USSR accelerated starting from 1992. According to Broadman (2004) in just 12 years after starting privatization Russia has already privatized more than 140 thousand enterprises and most of them was in first few years. Land in rural areas started to be distributed among the inhabitants. Ban on foreign investment on Russian economy has been removed. Russian currency has been made convertible to foreign currencies.

2.3.3. Macroeconomic analysis of reform periods

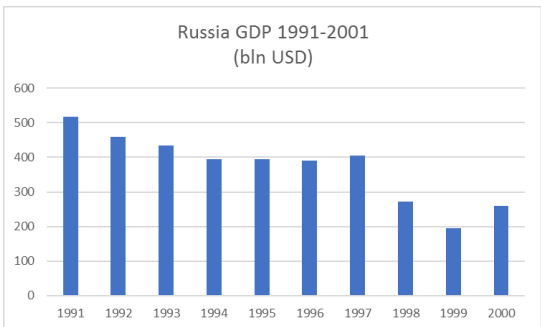
In order to quantitatively compare macroeconomic situation of China and Russia first 10 years and latest 5 years of transition periods can be analysed.

As can be seen from Graph 2. and Graph 3. China has experienced an increasing trend in terms of GDP while Russia’s GDP decreases significantly over time for the first 10 years of transition.



Graph 2: GDP of Russia for first 10 years of reform period.

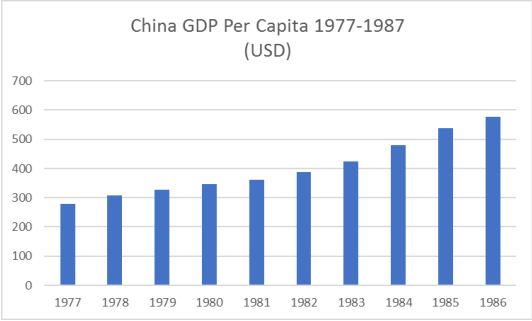
Source: www.tradingeconomics.com



Graph 3: GDP of China for first 10 years of reform period.

Source: www.tradingeconomics.com

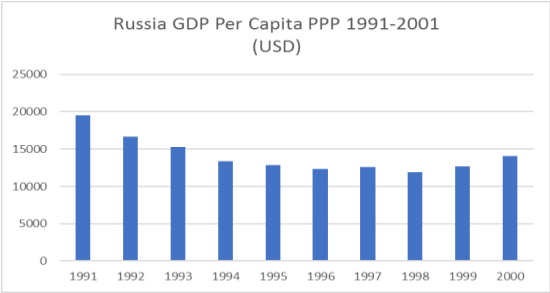
To see a country’s development, it is more important to analyse the GDP Per Capita than GDP itself. Graph 4. And Graph 5. show data for GDP per capita of Russia and China respectively. Russia has many times more GDP Per Capita than China. But China is again in increasing trend as expected. Here we can understand that China’s population was getting better and better living standards year by year while Russia’s population was getting poor and poor.



Graph 4: GDPPP of Russia for first 10 years of reform period. Source: www.tradingeconomics.com



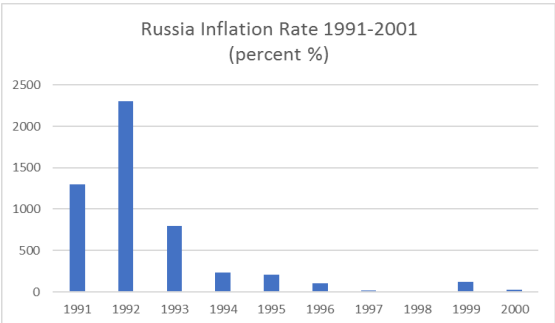
Graph 5: GDPPP of China for first 10 years of reform period. Source: www.tradingeconomics.com



Graph 6: Russia GDP Per Capita PPP for first 10 years of reform period. Source: www.tradingeconomics.com

GDP Per Capita PPP is also an important indicator to analyse well-being of a country. But the situation is nowhere different for Russia again, people are getting worse off in real terms as well as shown in Graph 6. Unfortunately, there is not enough data available for China’s GDP Per Capita PPP for the related period but do not expect a

different scenario than the GDP Per Capita case.



Graph 7: Russia Inflation rate for first 10 years of reform period. Source: www.tradingeconomics.com

If we look at the inflation rates of Russia for first 10 years we can see very dramatic rates with a high of 2300%. While inflation gets a bit lower in during 1997-1998, in 1999 economy again faces very high inflation rate. (Graph 7.) It means economy has been very unreliable during first few years in Russia. Inflation data for related period is also not available for China but if we look for

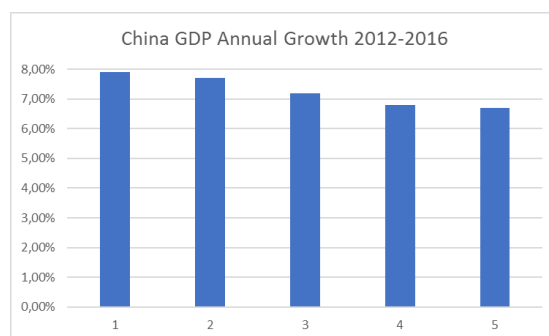
general statistics China’s inflation rate has been varied between -2.2% and 28.4% which is way lower than Russia’s record. (China NBS)

Now we turn to the economic indicators of China and Russia for last 5 years.



Graph 8: Russia GDP Growth for last 5 years of reform period.

Source: www.tradingeconomics.com



Graph 9: China GDP Growth for last 5 years of reform period.

Source: www.tradingeconomics.com

If we look at the respective GDP growth rate of Russia and China (Graph 8. and Graph 9.) Russia's GDP is still not a stable or growing one. Meanwhile, China experiences a stable growth.



Graph 10: Russia Inflation Rate for last 5 years of reform period.

Source: www.tradingeconomics.com



Graph 11: China Inflation Rate for last 5 years of reform period.

Source: www.tradingeconomics.com

Currently Chinese economy is the largest in the world in terms of PPP and second in nominal terms. Other than unstable GDP Russian economy still experiences relatively high inflation rates, while China had reached a stable economy with low inflation rates. Graph 10. and Graph 11. show the situation.

3. RESULTS OF ANALYSIS

3.1. Effect of timing and initial conditions on reform experiences

The initial conditions were one of the deterministic factor for the decision on reform strategy. In China, the problem was with the economy and policies. There was no need to change the government but the managing style of the economy. But in Russia the main problem was the corrupted government and state authorities. At the last years of USSR government tried to

follow China's strategy but was not successful at all. So, it was not considered to be impossible to carry gradual economic reform strategy in Russia and government had to be replaced.

Other than that, as mentioned before, initial conditions in China can be characterized with very poor economy and people with very low expectations about life. It was easy to carry reforms with them because they had nothing to lose opposed to Russian people who had much higher life standards and would oppose any policy that would make them worse off. It is easier to start from nothing and have a high growth rather than having a problematic economy which has come a long way during more than 70 years.

When China started transforming the world was not as competitive as when Russia started and technology was not as advanced. It means it was easy for China to adapt to the world after opening its borders when compared to Russia.

3.2. Importance of the chosen strategy

The strategies chosen by China and Russia was not only a result of the initial conditions but also whether they listened to western countries and international organizations or not. No matter why they have chosen their respective strategies China's strategy was offering more independence to Chinese government to decide what to do next and was less risky as they could see what expects them after one step and changing an unlucky policy attempt back was not as difficult as Russia's one. Gradual changes let China know whether they are in the right direction or not. But Russia did not have such a chance.

China did not let foreign countries and international organizations to intervene its decisions much while Russia followed the strategy offered by them. This let China to analyse and do whatever government thought was best for the economy but Russia could not do the same thing as a result of both western suggestions and the reforms being rapid.

3.3. Role of external factors

Even if the strategy chosen by Russia was the right and appropriate one some other factors might still be enough to make Russia's transition unsuccessful.

As mentioned before, crime rates and illegality in Russia was very high. It was making the implementation of policies very difficult. Other than that, even if they changed the structure of

the state governance, it is not easy to change all levels of governing hierarchy in a very short period of time, at least, the number of candidates would not be enough to replace everyone. So, the corruptness of the government in lower levels still continued to be the case during the most important times of transition.

Wars within Russia and between other post-Soviet countries also played an important role. These did not let Russia to have a stable economic and political period for implementing its policies as she wants.

4. CONCLUSION

Chinese reform strategy with gradual changes with state directives was quite different from Russia's rapid transition strategy to market economy. China started with one of the poorest economies of the world and became one of the largest. There were several major reasons behind the China's success. Initial conditions of China made it possible to keep the political structure and run gradual reforms. Timing of starting reforms of China made it easier to adapt the world. The strategy followed by China was less risky and policies were easier to analyse as they were gradual. Political and social situation in Russia during early years of reforms were not suitable for a successful transition.

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