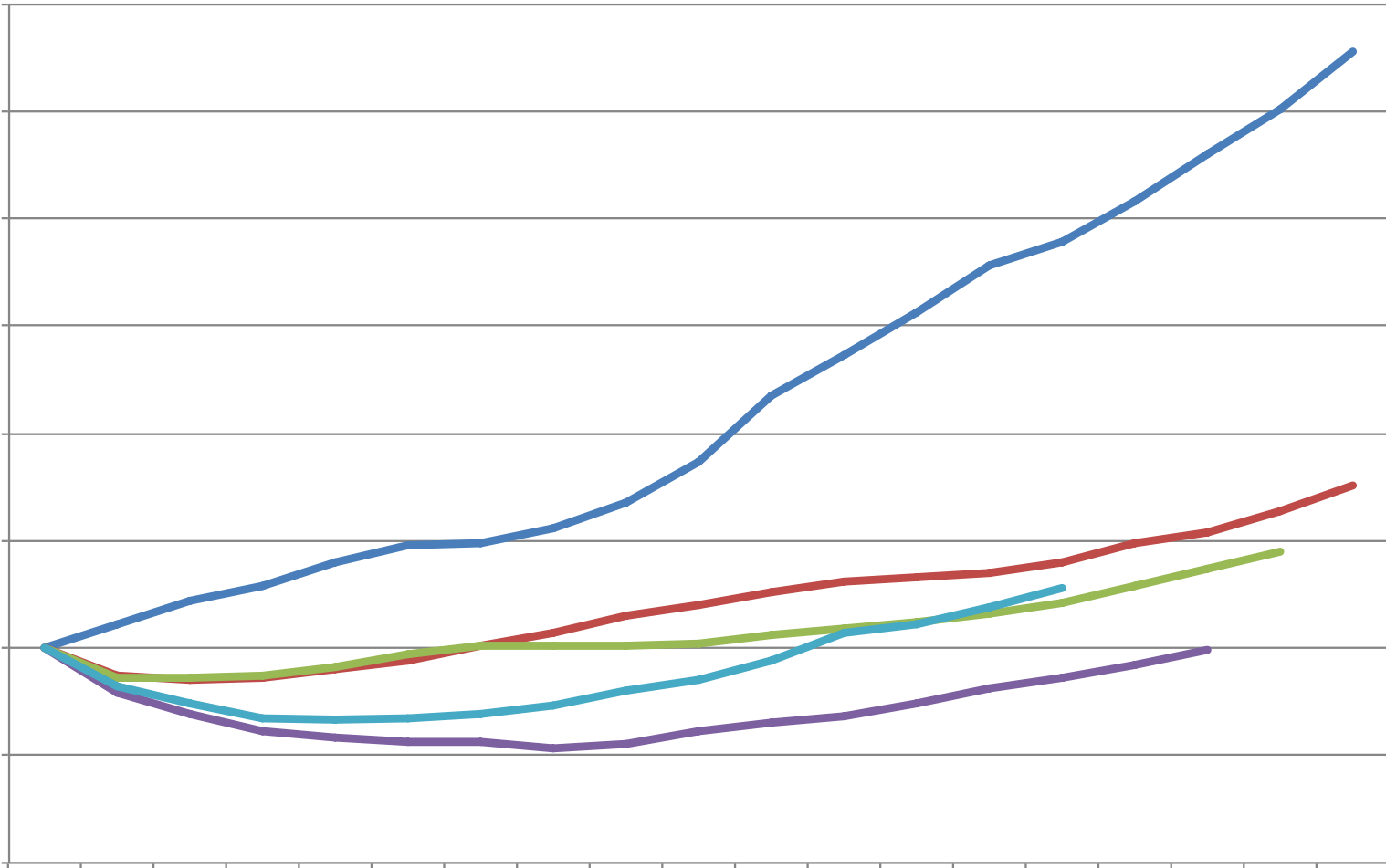


The Evolution of Post-communist Economic Systems

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Introduction

- Nearly 40 years after the beginning of economic reforms in China and more than 25 years after transition in Central and Eastern Europe, having studied these issues all my career, I propose a **new perspective on how to interpret the evolution of post-communist systems**.
- In the first decade of China's reforms, observers criticized partial and gradual character of Chinese reforms starting reforms only with countryside.
- Hope that radical political change in Central and Eastern Europe would lead to better performance following more comprehensive reforms.
- This proved wrong at the time: output fall and growth performance strongly below that of China. Transition delivered many surprises.

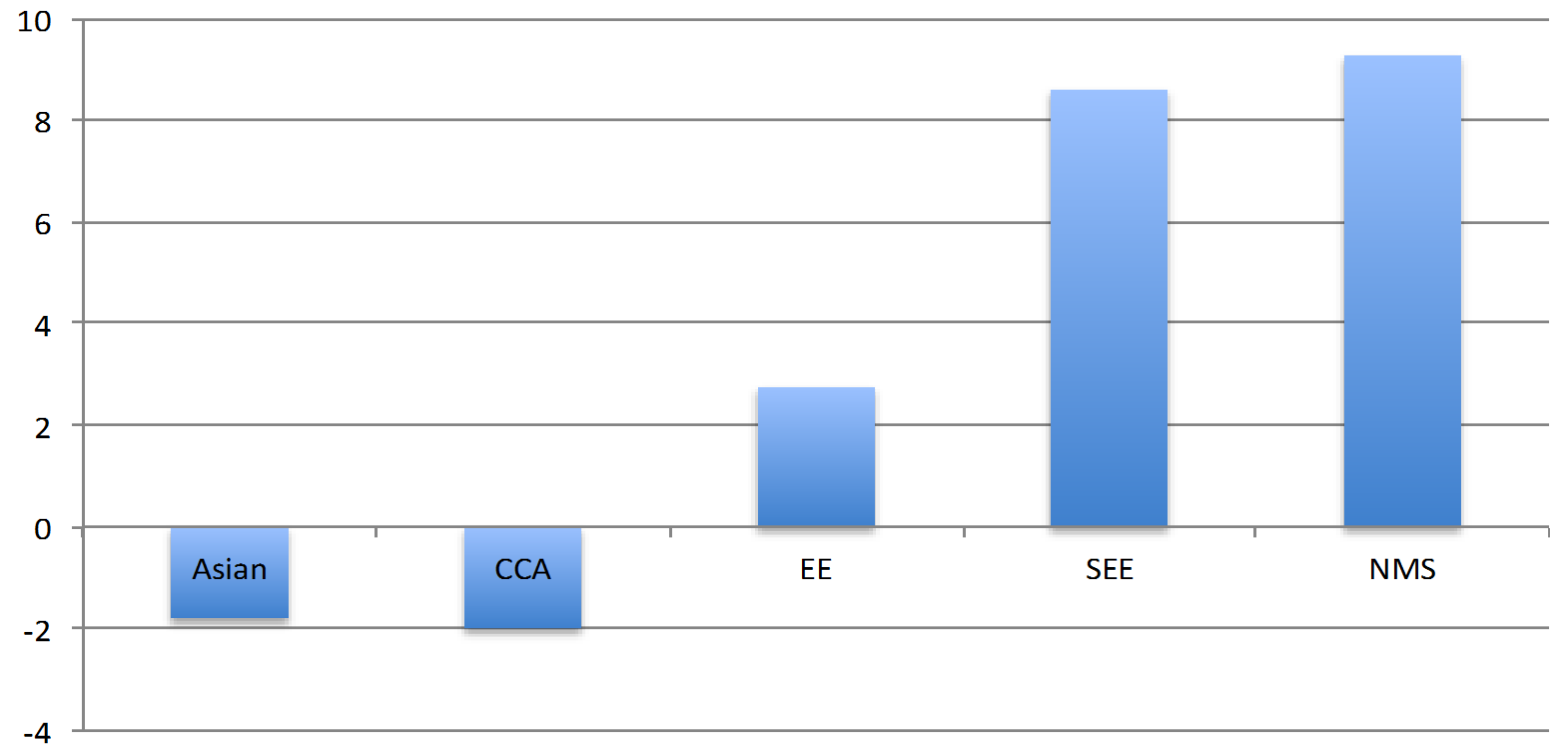


sia (1992)
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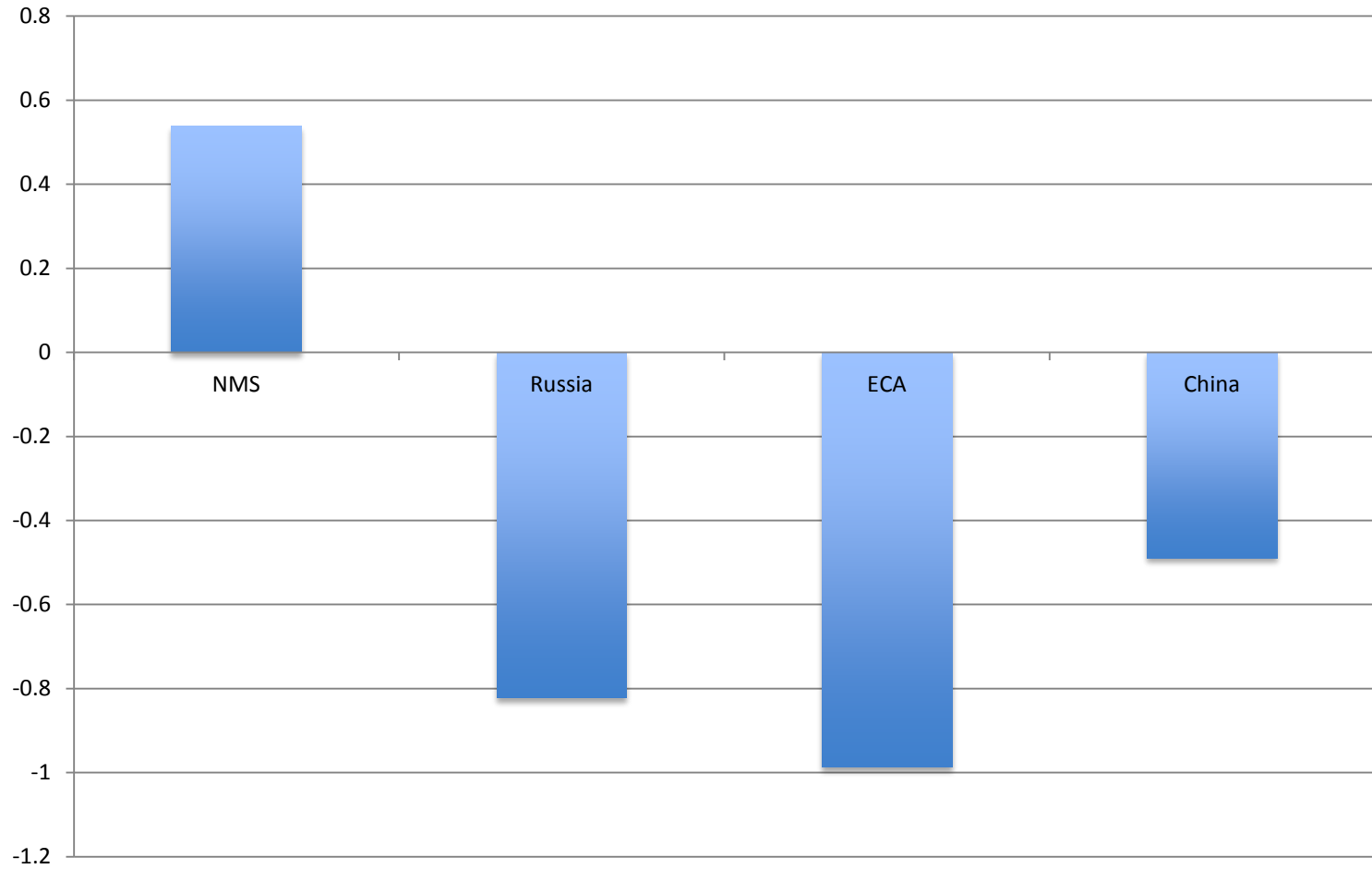
Introduction

- The surprises of transition led to lots of research to understand both the economic success of China, the output fall in Eastern Europe, and also the difference between New Member States and Former Soviet Union. **Much stronger and longer output contraction in the latter explained by difference in the quality of institutions.**
- **Accession to European Union played an important role in anchoring institutions** in Central Europe and New Member States.

Polity score 2012



WB Rule of Law 2012



Introduction

- Why bad institutions arose outside accession countries was never really explained. In Roland (2014), I emphasized the role of democracy, and differences in civil society and values and beliefs on democratization (more on this later), but this is too partial. **Central to understanding transition history should be understanding the evolution of the communist state.**

Introduction

- I want to take a longer historical perspective on the evolution of former socialist economies in China and Eastern Europe, not focusing on particular policies but on the long run processes that have been at work.
- I want to see transition in Central and Eastern Europe less as a process of reform and more as a process of **disintegration of the communist state apparatus**.
- In contrast, China's evolution is characterized by the conscious replacement of central planning by the **market economy to keep the communist party's control over political power**.
- These new interpretations of transition have important implications.

The erosion of the communist state apparatus in Eastern Europe.

- Under socialism, **communist party concentrated all political AND economic power** in its hands. In the long run, this proved a toxic mix for communist Soviet leadership.
- The burden of managing an economy with no real balanced central plans and more economic complexity (more goods differentiation, more input complexity, more economic links, ...), without using the market as central resource allocation mechanism, led to economic stagnation and **gradual erosion of communist power** (Roland, 1989, 1990).

The erosion of the communist state apparatus in Eastern Europe.

- Central planning necessitated that orders be obeyed, at least not challenged, but a strong authority of the center could not be sustained in the long run.
- Legitimacy requires sense that Center is in control: has sufficient coordination capacity as well as power to execute its threats of punishment.
- In reality, plans were never balanced. In the early years of planning, what mattered mostly was priority coordination of steel, coal and heavy industry. Campaign-style management, ideological enthusiasm, terror and Stakhanovism made things work.
- As things became more complex, mobilization was replaced by cynicism, in a situation of chronic shortages, **enterprise managers realized that their bargaining power was relatively strong towards the center.**

The erosion of the communist state apparatus in Eastern Europe.

- Stronger assertion of bargaining power of managers meant simultaneously **erosion of authority of central planners.**
- Central authority had been eroding at different speeds in different countries.
- In countries where it had been eroding faster (Hungary, Poland, Yugoslavia, USSR under Gorbachev), this was interpreted as partial reform towards the market economy, but it was primarily an increase in the bargaining power of managers towards the center.

The erosion of the communist state

- **Step 1:** elimination of mandatory planning replaced by some form of non-binding plan;
- **Step 2:** increase in decision-making autonomy of managers, in particular on prices and wages;
- **Step 3:** privatization of assets to managers, be it via spontaneous privatization, MBOs, mass privatization,...
- Under the communist state, there was also gradual reduction of power of state apparatus versus civil society and economic sphere, bargaining over extent of rents achievable outside the state apparatus. Monopoly power of communist nomenklatura elite yet unchallenged.

Transition processes

- In Central and Eastern Europe, transition started with **political overthrow of elite in power** after threshold of weakness of communist state had been reached.
- In China, transition started as economic strategy to **strengthen the monopoly power of the communist party** after pragmatic realization that central planning was less effective than market economy. Circumstance of new team of leaders who had been punished under the cultural revolution.

Transition processes

- In Eastern Europe, collapse of communism from the top led to **competition between different networks to grab pieces of power** of the defunct communist state for their private benefits.
- Two types of strategies:
 - Grab directly power positions to enrich oneself (corruption, predatory behavior, asset-stripping)
 - Use connections in state apparatus (government + administration) to grab assets (privatization, tenders, fines,...) and economic power

Example of privatization

- Privatization was the biggest opportunity to use influence activities to influence allocation of assets:
 - Political **influence** to establish **privatization policies** that maximized the rents for those receiving control over assets (via free distribution of the assets for example), usually insiders but also would-be oligarchs with connections;
 - **Influence** the administrative process via corruption to divert **outcomes** in one's favor

Privatization and political power-grabbing

- Reciprocal consolidation of economic and political power.
- Use the market power received from **privatization policies** or **regulatory capture** *or* any other influence activity to increase not only one's wealth, but one's influence inside the state apparatus, which made it easier to further enrich oneself.

Examples

- Ukraine, a perfect example of competition between various oligarchic networks: Akhmetov, Pinchuk, Kolomoisky, Firtash, Timoshenko, Poroshenko,... Privatizations in the Kuchma area nearly all rigged towards oligarchic interests. Power shifts between different groups of oligarchs
- Russia: massive wealth transfers under mass privatization and “loans for shares” scheme; shift in power of oligarchs under Eltsin and under Putin.
- Generalization of corporate raiding.

Examples

- Czech Republic and Slovakia: Nomenklatura benefiting from privatization (along with adventurers) and corruption in judiciary and government administration to cover up economic predatory behavior.
- Poland: siphoning of bank assets by former Nomenklatura insiders. Role of Foreign Trade Centers.

Competition between networks

- Competition between different networks (Nomenklatura **insiders**, **outsiders** looking for fast enrichment, networks from **former secret police**, **criminal networks** taking advantage of collapse of communist state) implies lawlessness, collaboration with organized crime, use of power positions within portions of the state (political, judicial, administrative positions, positions in SOEs and state-owned banks), threats and use of violence.
- Competition leads to conflicts and deal-making in the shadow of the law.

Newly emerging state structures

- Bad institutions directly a consequence of the collapse of the communist state and of competition among former Nomenklatura networks to grab pieces of power. No internal incentive to introduce rule of law.
- The implosion of communism explains the organization of the state: prevalence of influence networks and clans, generalized corruption and use of direct or indirect power positions for enrichment and siphoning away of resources.
- **Kleptocratic state** where. **state power is used like an ATM machine.** Much more severe than the soft budget constraint phenomenon.

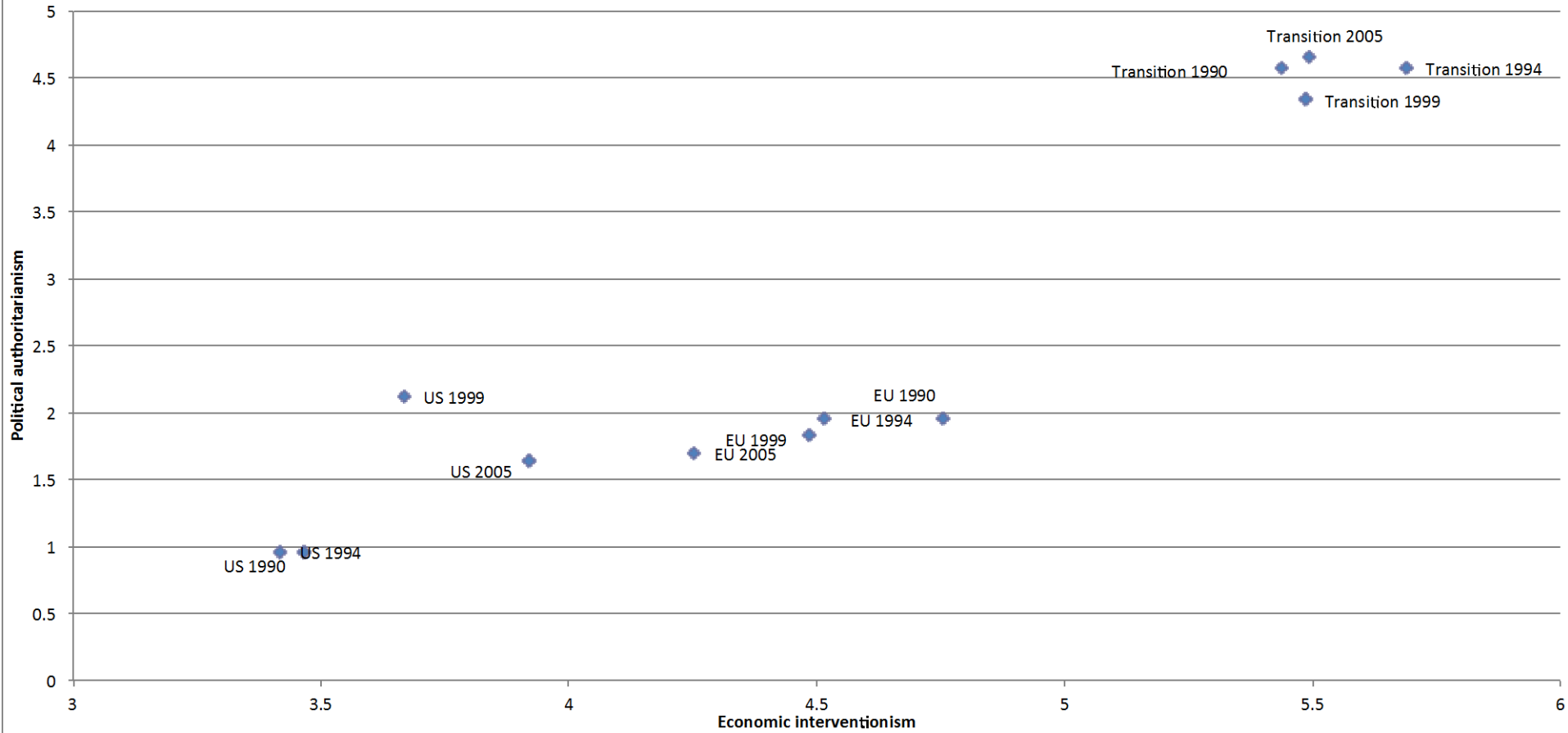
Countervailing effects? 1. Civil society

- Low level of civil society development leaves this transformation of the state unchecked, as population that is victim of exactions of the kleptocratic state remains relatively passive and fatalistic.
- Higher level of civil society development (see Bruszt et al. 2012) can, however, act as countervailing power. Countries like Poland, Czechoslovakia, Estonia had higher level and stronger maturity of dissident activity, which affected initial political institutions: lower concentration of power in the hands of the executive, more separation of powers and more inclusive institutions.

Countervailing effects? 2. Culture.

- Reaction against kleptocratic state is not only about level of activity of civil society, it is also about culture and values inside society.
- In former transition countries, even among New Member States, values are more authoritarian and in favor of government intervention. They are also more nationalistic and more favorable of discrimination of women, homosexuals, ethnic minorities, foreigners. These values have not changed much since transition.

Inertia in economic and political values



Countervailing effects ? 3. EU accession.

- EU accession provided an external check on the formation of kleptocratic states. Incentives to enter the European Union dampened kleptocratic behavior compared to non accession members.
- This effect was stronger before entry than afterwards. EU is not good at punishing its own members. Autocratic drift in Hungary left virtually unchecked.
- EU still provides institutional support. Example: fight against corruption in Romania.

Some implications of this reconceptualization of transition.

- **Implication 1:** Despite not introducing “the right institutions”, the state apparatus inside post-communist countries has been deeply transformed **from communist absolute power monopoly to kleptocratic turfs** of various stability shared by various networks.
- **Implication 2:** Reforming post-communist state with failed institutions is of a different nature than reforming communist state under democratic and market transition. Transition’s main challenge was reforming the economy, current challenge is ousting corrupt vested interests. **Requires deeper and long term transformation.**

Evolution of Chinese system.

- In the light of stagnation of USSR in the seventies and chaotic (and lunatic) Maoist management of the economy since 1958, Deng Xiaoping thought that best bet to consolidate power of CCP was to introduce market economy, following the examples of Taiwan, Hong Kong and Singapore, not to return to central planning of fifties.
- Deng used power of CCP to unleash market forces relying on **government decentralization and yardstick competition (meritocracy)**. This process eventually **reinforced power of CCP** in all spheres (military, education, press,...) instead of decreasing it.
- Private entrepreneurs can since 2001 become CCP members.

Evolution of Chinese system.

- Initial thinking was that political reform would sooner or later follow economic reform (didn't USSR have a political transition?). If anything, the opposite happened.
- Mistaken view. **The transition to the market economy was decided with the goal of preserving and consolidating the power of the CCP.** So far, this has been an unmitigated success!
- China's current system is one of **CCP power over a market economy.** Growth objectives were pursued using existing CCP institutions. CCP power has not faded with progress of market economy. On the contrary!
- CCP has probably become the most powerful organization in all of world history.

Evolution of the Chinese state.

- The reinforcement of communist state power has led to a **state structure that is very different from that in Eastern Europe (even the non democratic states)**.
- The communist party stays very united (democratic centralism) and controls all the power levels.
- The state is able to impose hard budget constraint on enterprises.
- Absence of democratic leader selection implies more censorship and restrictions on freedoms.

Challenges of market economy for CCP

- Challenge of obsolete communist ideology?
 - Not necessarily. Haifeng Huang (2015) “Propaganda as Signalling”. Zhao Gao episode: “calling a deer a horse”. Cultural difference in meaning of communication. Lemin Wu (2015) on Confucianist etiquette.
 - The weakness is that if leaders are perceived as weak, ideology cannot be used to enhance their legitimacy. Power and not being seen as weak are the only things that matter in order to prevent challenge.

Challenges of market economy for CCP

- Challenge of corruption:
 - Purchase of government and party positions for money;
 - Trade-off between promotion chances and bribe-taking;
 - Danger of private enterprise networks controlling large wealth being independent from the party.
Answer so far: party control inside private enterprises and cooptation of successful entrepreneurs.

Challenges of market economy for CCP

- CCP has a genuine interest in fighting corruption, but choice of market economy brings strong internal tension: communist leaders at different levels should promote growth but simultaneously behave ascetically (communist monks handling large wealth-making machine). Emergence of corruption difficult to stop without enough legal economic incentives. Anti-corruption campaign likely to dull incentives at lower levels.

The stability of the Chinese political system.

- Nevertheless, one should not underestimate the stability of the system. Main tasks of power structure are not challenged:
- **Solving the succession problem:** Mandatory retirement at 65 for CC level leaders and 68 is maximum age for PSC nomination. Age interval between 50 and 68 reduces number of candidates.
- **solving informational problems:** Top party leaders have always used vertical channels of information. Reporting duties important at all levels. Vertical channels have failed severely at times (Great leap forward). Leaders have learned to rely on alternative sources of information: tolerance of local revolts, whistleblowing (SARS), social media,...

The stability of the Chinese political system.

- **Taxation and state capacity** not a problem. Significant state ownership gives direct control over state resources. CCP has additional instrument of party mobilization, which can at times mobilize resources. Mobilization and campaigns are a standard instrument of CCP that can be used in exceptional
- **Leninist organizational form** designed to keep party unity, party-government duality additional factor of stability against revolts. **Collectivist culture** well suited to existing political institutions.

Some implications of this reconceptualization of Chinese transition.

- **Implication 1:** The success of Chinese market reforms is not despite the power of the communist party, but because of it. Growth objectives pursued via meritocratic competition and reinforcement of the power of CCP over the economy, personnel decisions, the army and the media. Power is both the instrument and the goal of CCP.
- **Implication 2:** There is little hope of gradual political reforms in China in the direction of democratization, sharing or separating powers or accountability to the people. China will either continue being a sui generis modern economy under absolutist CCP rule (with delegation from party to government) or be subject to a process of state erosion via corruption reaching ever higher organs of CCP.

Conclusion.

- Transition outcomes in Central and Eastern Europe better understood by dynamics of state erosion rather than by particular policies. Reforming post-communist kleptocratic states very different challenge from transition.
- China made a major gamble on institutional innovation: market economy under communist rule. Faces specific survival challenges in the future, but there are few hopes of major political reform.