

## **Introduction**

Although former Soviet countries and China share both a communist past, differences exist in how the countries operate today. This paper will examine these differences and will look at how these came to be. It will take the economic, social and political starting conditions and, based on them, will look at the transition these countries have undergone in past 30 years. By looking at the pace and sequence of the reforms in both regions it will connect the past and future. Here, the differences and similarities in strategies will be taken into account to take a look in the future and the economic and social challenges it may bring.

## **Starting conditions**

To compare the starting conditions between China and former Soviet countries three aspects will be looked at: economic conditions, social conditions and political condition. Together, these will provide a complete overview of the starting conditions of both regions.

### *Economic starting conditions*

The economic starting conditions of both countries were vastly different. Former Soviet countries in 1990 had a GDP per capita of between \$5160 (Poland) and \$10540 (Czech Republic). China on the other hand only had a GDP per capita \$800 (World Bank, 2015). This huge difference in economic output is one distinction between these two areas. However, other more structural differences existed. For example, the industrialization of economies differed. Where the economies of former Soviet states had been highly industrialized (with an important part of this being focused on military production), the Chinese economy was not nearly as industrialized. This was the result of the degree to which labor was available: China had a labor surplus and the former Soviet Union a shortage. This combination of industrialization and the availability of labor resulted in an ineffective and over-industrialized agriculture sector in the former Soviet Union (Bernstein, 2010).

### *Social starting conditions*

The social starting conditions regarding social benefits were different as well between the countries of the former Soviet Union and China. The main difference here is the people who were covered under the social security scheme. Before reforms in China only public sector employees were covered under these programs. This was roughly 20% of the population. In the former Soviet Union however, not only more people were covered (everyone) but the level of social services was also higher. This level and extend of social programs made that this became an excessive burden for former Soviet countries (Shue & Wong, 2007).

### *Political starting conditions*

The political situation in both regions was also different. With communism in its latest stages in the Soviet Union, political leaders were unable to use coercive measures on a large scale. This eventually led to spontaneous rebellion against the people in charge and ultimately the fall of the Iron Curtain and the collapse of the Soviet Union. In China however, communism remained strong with no signs of struggle. The command system remained strong and no need for democratization was present as was the case in the Soviet Union (Dabrowski, 2014).

### **Pace of the reforms and sequence**

The differences in the economic, social and political situation between countries in the former Soviet Union and China resulted in the different implementations of the reforms. Also, the pace in which the reforms took place differed. In the actual implantation of the reforms pace and sequence are important determinants of its success. Therefore, these factors will be examined for the two different regions.

With regard to the pace of the reforms the Chinese reforms were much more gradual compared to those in former Soviet countries. This was mainly due to the structural macro-economic imbalances in the former Soviet Union that required much faster changes to ensure long-term economic stability (Murrel, 1993). First, a need was present to drastically cut social spending in the former Soviet Union. As spending levels had reached an unsustainable level that threatened the economy, a quick intervention was needed to bring spending levels in check with economic output. Secondly, a quick transition was possible due to the high level of industrialization that already had taken place in these countries. It was therefore relatively easy to privatize existing industries. Third, the lack of power of the governments would not have allowed for a fine tuning of the economy which takes place in a more gradual transition. China on the other hand was able to transition more gradually. Due to the relatively low levels of social spending no drastic changes were needed, the lowly industrialized economy allowed for a gradual build up of this sector and the strong power of government allowed for control and fine tuning by those in power (Murrel, 1993).

The reforms in the countries of the former Soviet Union consisted of four distinctive macroeconomic stabilization, liberalization, privatization & enterprise restructuring and institutional & legal reforms. The macroeconomic stabilization reforms involved a fiscal adjust by reducing price subsidies and the governmental investment spending. As many products were subsidized this affected many people. A second stabilization involved stopping the quasi-financing activities carried out by the central banks. This required the creation of more banks which could take over this function of the central bank. Furthermore, the central bank had to become more important in economic policy making by controlling exchange rates. To do this it had to become more independent of the state to ensure proper functioning. These shocks in the macroeconomic situation led to wage control to prevent inflation to rise out of proportion (Dabrowski, 2014).

The second reform included the liberalization of many markets. This included limiting subsidies and deregulation. For entrepreneurs, this meant that they could start businesses with less bureaucracy and could more easily trade with other countries (outside the Soviet Union). As discussed in the previous

point, banks could establish itself more easily which caused an abolishment of interest rate control. However, liberalization alone would prove not to be enough to transfer the economy. Therefore, privatization of state enterprises was necessary to enhance economic growth. To do this corporations were set up as an intermediate step to privatization. Experiments were carried out with ways to privatize these corporations (Dabrowski, 2014).

In order to legally support all these changes, legal reforms were carried out to facilitate the transition process. These included the creation of a professional and independent judiciary and public service system (Dabrowski, 2014).

The Chinese reforms can be classified into three distinct stages: the de-collectivization of agriculture (early 1980's), the decentralization of government (late 1980's – early 1990's) and the liberalization of markets (late 1990's – early 2000's). The first stage of reforms included four main features: the de-collectivization of agriculture, the introduction of a dual pricing system for industry, the allowing of private firms and the opening of China towards foreign investment. The de-collectivization of agriculture was characterized by communal plots of lands being split and divided amongst individuals. After paying a share to the state, farmers were able to keep the rest of the agriculture yield resulting in incentives to produce more and increased living standards of hundred thousands of people. The introduction of a dual pricing system for industrial product and commodities was introduced to incentivize production in non-agricultural sectors resulting in an increase in living standards. Privately owned firms were allowed for the first time since the Communist era and foreign investment was allowed for the first time since the Kuomintang era. Special economic zones were created for this purpose with significantly less bureaucracy in order not to hinder economic growth (Qian, 2002).

The second stage of economic reforms continued in the previous reforms but was characterized by a strong influence of the regional level. In the privatization of state enterprises local and regional governments were free to experiment with the best way to do this. The re-opening of the Shanghai stock exchange was a clear sign private enterprises had begun to play an important role in the Chinese economy. However, this economic freedom was in sharp contrast with the political freedom at the time as can be seen from the suppression of the Tiananmen Square protests (Qian, 2002).

The third wave of reforms was possibly the most radical. It involved the liquidation of many state owned enterprises, the opening up of China to the rest of the world by reducing trade barriers and tariffs, the unifying of exchange rates and China joining the WTO. These radical reforms were possible as a result of the retirement of most of the conservatives (such as Chen Yun) which had opposed these kinds of reforms for a long time (Qian, 2002).

### **Current economic systems**

The current economic system of countries in the former Soviet Union is diverse but overall turned out very well. Most economies are now governed by market mechanisms and the private sector contributes between 60% and 80% of GDP. However, exceptions to this also exist such as Turkmenistan (25%) and Belarus (30%) (Dabrowski, 2014). Most of the countries are open to international trade and foreign investment making it more accessible than before the reforms. Freedom in countries of the former Soviet Union is diverse. Some countries are performing well (for example Estonia and the Czech Republic) but some are performing very poor (for example Belarus and Ukraine) (Dabrowski, 2014).

The results of China's reforms have been significant. With annual growth rates of around 10% China has seen an economic boom making it the second largest economy worldwide (in terms of absolute GDP) after the United States. However, it still lacks behind in terms of GDP per capita and purchasing power (World Bank, 2015). It has become the world largest lender and manufacturer. Even though the reforms resulted in an increase of inequality, it also has helped in reducing poverty by increasing the living standards of everyone. China's economy is relatively stable for transitioning economies setting it up for long term successes (Qian, 2002).

### **Differences in reform strategies and outcomes**

With regard to the reform strategies differences can be seen between the former Soviet Union and China. Where the former Soviet Union took a more radical approach towards reforms, China took a more gradual approach. This was the result of the starting conditions before the reforms as discussed earlier. The differences in the economic, social and political situation of both regions made these differences possible. As both approaches have their benefits and disadvantages, both can be appropriate under the right circumstances (Dabrowski, 2014).

### **Forthcoming economic and social challenges**

Besides the different approaches in reform strategies, the former Soviet Union and China each have distinct economic and social challenges ahead of them.

The major challenges for countries from the former Soviet Union are the following: the effects of the financial crisis, the struggle to incorporate businesses, the possibility to be marginalized in the world economy and an unsustainable welfare state (Dabrowski, 2014). The financial crisis has significantly decreased growth in the countries of the former Soviet Union. Pressures of inflation and higher government debts will provide challenges in the near future to maintain a balance in government spending. The need to improve the business climate in the Western Balkans is essential for further economic growth in this region. With help from the European Union this might be realized.

Marginalization in the world economy is a problem for countries in central Asia. Being landlocked, these countries face a relative decline in economic output. This might result in a relapse of these economies. The unsupportable welfare state in the Western Balkans and Central Asia has the potential to become a burden on public spending as these economies relapse (Dabrowski, 2014).

The major challenges for China are the following: the effects of the financial crisis, a forthcoming demographic crisis, limits to the export-oriented growth and ecological concerns (Qian, 2002). The financial crisis shed light on the imbalance of the exchange rates and the undervaluing of the RMB currency. As the world biggest lender, China saw its foreign loans decrease in value. The demographic crisis China will face in the future is a serious problem. With a gender gap and an ageing population China might face a labor shortage in the future. Also, the export oriented strategy is highly dependent on the global economic climate (Shue & Wong, 2007). In times of an economic downturn the leading manufacturer in the world will be affected. Therefore, China is trying to stimulate its internal economic growth to be more resilient against economic hardship in other place around the globe. The final challenge is that of ecological concerns. Even though the economic developments have brought

prosperity to the Chinese, it came at the cost of ecological pollution. Smog, high CO<sub>2</sub> emissions and pollution has been the price of this economic prosperity and although measures are being adopted to decrease the extent of this problem, it will still remain a problem in the near and medium future (Qian, 2002).

## Conclusion

Differences exist between the economic transitions the former Soviet Union and China went through have impacted how their situation is today. From different starting positions in the economic, social and political domains both regions have transitioned into emerging economies. The differences in starting conditions affected the path for transitions: in the former Soviet Union a shock therapy approach was adopted where China had a more gradual transition. Currently, China is facing huge export-oriented growth and has become the country with the second highest in the world. However, inequality has grown and environmental conditions have worsened. The former Soviet Union has been less successful after the reforms. With the financial crisis of 2008 still nearby, it is struggling to recover from this.

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