

Structural factors in the economic reforms of China, Eastern Europe, and the Former Soviet Union

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Summary

Reform in China and Russia

Jeffrey Sachs and Wing Thye Woo

China's experience does not show that gradual reform is superior to the shock therapy undertaken in Eastern Europe and the Former Soviet Union (EEFSU). Differing performance primarily reflects different economic structures prior to reform: China was a peasant agricultural society, EEFSU was urban and overindustrialized. In both, jobs in state enterprises were so heavily subsidized that workers refused to move to new industries elsewhere, even when productivity in the latter was much higher. In EEFSU the large state sector impeded structural adjustment. Curtailing subsidies would have produced many losers who used their power to resist this outcome; failure to curtail subsidies then cut off the potential supply of labour and other factors to new emerging firms. China's state enterprises have not performed as well as the rest of the Chinese economy and do not explain its success; rapid growth was possible because the large agricultural sector contained vast surplus labour, and did not enjoy subsidies and soft budget constraints. Once constraints on migration across regions and jobs were removed, this labour was available to fuel expansion in new industries. Unlike the distributional conflict in EEFSU, in China reallocation of labour allowed all groups to gain.

In both, partial liberalization also unleashed macroeconomic pressures, manageable in China because of rapid growth and adequate monetary policy, but explosive in much of EEFSU because of deeper structural problems and gross monetary mismanagement.

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