Against 'big bang' in economic transition: normative and positive arguments

Shu-ki Tsang*

(An edited version of the paper was published on *Cambridge Journal of Economics*, 1996, vol. 20, pp.183-193)

This paper puts forward two major sets of institutional and systems arguments against implementing the 'big bang' experiment in the transformation of centrally planned economies: (1) problems arising from the difficulties of establishing criteria for asset valuation in the transition and the large backlog of the 'implicit contracts of socialism'; and (2) the danger of unleashing uncoordinated changes in sub-systems that adjust at significantly different speeds. These arguments, covering both normative and technical considerations, are cast in a relatively broad framework and constitute an additional plea for caution against adventurism in the economic transition.

1. Introduction

The debate on the transformation of the 'centrally planned economies' (CPEs) in the former Soviet Union and Eastern Europe has been dominated by analysts of two significantly different approaches. The 'big bang' theorists advocate the rapid replacement of the traditional system by private property rights and the market mechanism (see e.g. Lipton and Sachs, 1990A,B; parts of Kornai, 1990A; Popov, 1991; Sachs, 1992), while the 'gradualists' (e.g. Summers, 1990; Podkaminer, 1990, 1993; Charemza, 1991; McKinnon, 1991, 1992) caution against adventurist moves and stress the importance of coordinated sequential efforts under various structural constraints. A useful overview of their different inclinations is provided by Murrell (1992). In practice, the former approach has been experimented with in Poland and the results have, as yet, been mixed. A 'bigger bang' is in the process of being tried out in reborn Russia and some of its neighbours. Czechoslovakia, before it split, and Bulgaria also launched major 'shock therapy' initiatives. Other former communist regimes in Eastern Europe including Romania have been more cautious and can be regarded as adopting a gradualist line. China, at the other end of the spectrum, has been pressing ahead with its own version of reform, seeking a balance between the state sector and the market and emphasising the importance of avoiding disturbances that may arise from abrupt changes (see e.g. Fei and Reynolds, 1987; Chen, Jefferson and Singh, 1992; Tsang, 1992, 1993A). We are probably too close to history to pass any definitive judgment on the comparative success of these 'experiments'. Hence the debate has to go on.

Manuscript received 18 December 1992; final version received 7 January 1994.

*Hong Kong Baptist University. The author wishes to thank Woo Tun-oy, Y.Y. Kueh, Thomas Chan Man-hung, Cheng Yuk-shing, Louis Putterman, participants of a seminar organised by the Shanghai Academy of Social Sciences, and anonymous referees of the Journal for comments and suggestions. All remaining deficiencies are his own.

The arguments that both the above-mentioned 'schools' invoke focus on stability and efficiency considerations, which are largely technical in nature. Gradualists exalt the virtue of sequentialism and the benign effects of macro stability on efficiency and warn against the danger of chaos generated by the 'big bang'. The 'shock therapists', on the other hand, pinpoint the implausibility of gradualism, its lack of credibility given the political setting of traditional CPEs, and its harmful effects on micro efficiency.

This paper attempts to investigate the problems of the economic transformation of the CPEs from both normative and positive angles. My position solidly sides with the gradualists, but I think that their reasoning so far has been too narrowly based. An institutionalist perspective should in my view be made explicit, and systems considerations be addressed directly. To widen the horizon of the debate, two major sets of arguments will be presented here: (1) problems arising from asset valuation in the transition and from what I call the 'implicit contracts of socialism' that need to be settled in a fair and efficient manner; and (2) the considerations of the economy as an integrated system with components that may change at significantly different speeds.

The second set of arguments focuses on the issues of efficiency and stability, so far the main battle ground of the two schools. My contribution is to organise the key lines of reasoning from a systems perspective. The first set, on the other hand, incorporates but also transcends positive analysis, and tackles the problems of intertemporal equity in a changing economic structure. Their implications are not just ethical, although these are inherently important. Perceived unfairness or nihilistic chaos will generate a strong impact on people's behaviour, affect their working efficiency and produce discontent that may undermine social stability and the chance of the reform in achieving its objectives.

While hopefully throwing serious doubts on the 'big bang' approach, these two sets of arguments do not, by intention or in effect, form a 'general theory' of the transition. Moreover, it is beyond the scope of this paper to analyse and evaluate in detail the specific programmes adopted by different regimes in Eastern Europe, the former Soviet Union, or China, although for the purpose of eliciting illustrative examples to buttress contentious points, some key events in these countries are referred to. Despite a number of positive things that I say in this paper about the Chinese mode of transition, which has been gradualist in nature, I actually remain rather critical of it for neglecting structural problems (Tsang, 1990) and for the wrong sequencing of the various reforms (Tsang, 1993A,B). In any case, my aim here is to focus on a core of stylised ideas, which helps to provide more food for thought and extend the framework of the on-going debate. As the theory of economic transition is still in the early stage of formation, I think that such an effort is useful in itself.

2. Rapid privatisation, asset valuation and implicit contracts of socialism

Both the big bang theorists and the gradualists hold some views about the institutional legacy of the CPEs, but they have not, in my view, probed deep enough into its nature and significance in putting forward their proposals. A key issue is obviously that of property ownership: the economic reform involves the transformation of the public ownership of many assets into private ownership. The big bang advocates are, however, torn between the need for rapid privatisation and the lack of objective criteria for converting the property rights. Moreover, an important objection against the big bang proposal arises ironically from the very fact that there are important implicit contracts about the ownership of property and assets under traditional socialism, which have to be settled in an equitable and efficient manner. The marketisation and privatisation programmes that many shock therapists propose neglect the existence of such contracts and would therefore lead to unfair and counter-productive outcomes.[1]

In his incisive comments on the paper by Lipton and Sachs (1990B), Lawrence Summers points to what I regard as the 'Achilles heel' of the rapid privatisation programme: the lack of any objective criteria for evaluating assets and distributing property rights in the transition:

> Lipton and Sachs hold out the hope that by distributing rather than selling assets, the difficulty of valuation can be sidestepped. I think this is a chimera ….. Without a fair method of asset valuation, I do not see how they can be distributed equitably across different institutions. Excessively rapid distribution without accurate valuation will, I think, lead to blatant inequities down the road, between different banks and pension funds. If institutions are permitted to exchange blocks of shares, these effects will be accentuated. (Summers 1990, pp.335-6)

Summers then delivers a devastating critique of the big bang experiment in privatisation from a non-radical perspective and in a business-like manner.

> Essentially the fairness aspect of the privatisation dilemma boils down to the following. In the current climate of massive uncertainty assets have a low ex-ante value. If after everything, things work out well, there is a sense that those who received assets stole them, and there will be pressure for getting at the windfalls, pressure to undercut private property rights in the process. If after everything, things do not work out well, that is not a good outcome either. The only possible resolution is to delay selling or distributing assets until valuations become clearer. (Summers 1990, p.336)

Summers' critique, as far as equity is concerned, is forward looking in nature. It focuses on the difficulties of assessing the value of assets and property in a big bang and the likely harmful consequences of any arbitrary scheme: 'blatant inequities down the road' and social grievance no matter whether the reform succeeds or fails. Time is needed for any objective valuation criteria to emerge in the transition. I have little argument with him on that front, but there is a big hidden agenda which has not been addressed by him, or even by advocates of apparently egalitarian persuasion (e.g. those who support the 'vouchers system' of privatisation): namely, the implicit rights of many citizens to the previously state-owned property and assets. In contrast to Summers, my critique of the big bang in this regard could be described as 'backward looking'. The two aspects are however also linked, as the following discussion will show.

[1] There are some who would argue that rapid privatisation, no matter how unfair it is, has the merit of rendering the reform process irreversible by destroying the power of those who oppose the transition and creating a powerful asset-owning private sector; as a referee of this paper has pointed out (see the analysis and critique by Pickel, 1992). However, this is essentially a political argument, which leaves aside economic considerations in both the normative and the positive sense. Its validity also depends on the specific circumstances in the country. In the case of China, for example, the reform process now seems irreversible even without rapid privatisation. One could argue the same for developments in Vietnam.

The traditional debate about *de jure* versus *de facto* ownership under socialism is largely misplaced. It has frequently been argued that, although assets are theoretically owned by the people, albeit collectively, they are in effect controlled by the socialist state. So the workers, nominally the masters of the means of production, would feel impotent. Such feelings have serious repercussions on their behaviour in the spheres of production as well as consumption (Fang *et al*., 1990).

This view neglects two crucial points. First, the well-known prevalence of resource immobility implies that the difference between *de jure* and *de facto* ownership is not as great as commonly supposed. Lumps fixed assets in factories are seldom transferred and workers should feel a sense of 'owning' them, at least communally and jointly with the state. Second, even given weak individual, explicit control over assets, there are many other compensations. It is redressed, for instance, by the assurance of housing at very low rents, which in many cases extends for life. Another example is the practice of 'hereditary employment' by many large state-sector enterprises that hire the sons and daughters of their employees. There is no lack of many other forms of welfare and 'incomes-in-kind'.

These two considerations shed light on the debate on the viability of socialism. It is 'viable' because there have been so many forms of compensation to the presumably deprived populace in other ways; e.g. social security, low rents, guaranteed employment, etc. There are no doubt huge political and economic costs associated with the implementation of such a system, particularly as it evolves over time. In any case, the compensation schemes are especially important as we investigate the dynamics of the process of 'reversal', i.e. that of going from a regime dominated by public ownership to one of private ownership. The problem of dealing explicitly with these earlier implicit contracts has to be brought forward.[1]

For concrete illustrations, let us look at the privatisation of housing in CPEs. The difficulties surrounding the reform demonstrate clearly the complexity of the issues involved. In most CPEs, accommodation has been provided to workers at minimal rents. These low rents were a form of 'subsidy' which compensated for the meagre wages that the workers received. In a way, the 'subsidy' was an 'income-in-kind' for them, but it was a special type of income. In a market economy, the workers would be given much higher incomes, part of which would be saved and used as payments for mortgages for houses or flats. These mortgages typically last for 10 to 30 years, at the end of which the workers would own the property.

Rapid privatisation of all housing accommodation at market-determined prices without careful planning of commensurate compensation is tantamount to a unilateral violation of

[1] The Western literature on implicit contracts focuses largely on the explanation of labour market disequilibrium and macro-cycles in capitalist economies. In any case, this theory, first developed by Arthur Okun and others, still has important implications for transition economics. Schultz's reported comments on the paper of Lipton and Sachs on privatisation are instructive: "Charles Schultz observed that many of the behavioural norms that are taken for granted in Western economies, particularly those informing relations between firms and workers, are conventions that have gradually built up because they were economically efficient ….. Because newly liberated economies would have no such established conventions, the emerging new laws governing market relations may need to provide somewhat more social insurance and other protection than is now the case in Western economies' (Schultz, 1990, p.339).

the implicit contract of swapping wages for housing subsidies. Moreover, it leaves workers at the later stages of their careers in a helpless situation. How will they be able to earn and save enough to purchase their own flats, not to mention houses, when their prices increase by leaps and bounds? To be fair, housing should be privatised only if the implicit contracts between the former socialist state and its workers are honoured i.e. workers are fully compensated for their implicit rights to cheap accommodation. They are entitled to it because they have accepted very low wages for the job they have done, instead of demanding high wages, which would have enabled them to build up enough savings for a mortgage on permanent residential property.

Nevertheless, this argument needs to be cast in the proper context of the economic transition. After all, the issue is not just that of fulfilling tacit agreements and moral obligations, but also one of systemic transformation. The implicit contracts of socialism should be settled in such a way that both fairness and efficiency considerations are addressed and the transition is facilitated. Moreover, the state's own financial position has to be taken care of. What the Chinese have been doing in housing reform is instructive (see, for example, Qiu *et al.*, 1992). In general, a process of *gradually* increasing the rental rate and the purchasing price of residential accommodation has been implemented. In Shanghai, for example, it was planned that the rate and the price would be raised to market-determined levels over a period of about 20 years. Through innovative capital-raising arrangements including a provident fund scheme and the sales of housing construction bonds, citizens are given the choice of acquiring residential property at prices significantly below construction costs. Hence they can continue to enjoy subsidies in view of their implicit rights, although such precise theoretical justification may not always be in the mind of the authorities. They are also required to adjust to the new economic situation by earning higher incomes, increasing savings, and contributing to the housing reform, but they are given ample time to do so. The government would, on the other hand, benefit fiscally if that subsidy were to be reduced, and revenue increased, progressively over time. In other words, the government can also have sufficient time to honour the implicit contracts. It appears that such a gradualist approach is more likely to strike a balance between equity and efficiency, and nurture goodwill on the part of both the government and the public. My only argument with it is that different schedules of rental or price increases and patterns of preferential treatment in terms of subsidies should be applied to employees who have worked for different periods under the old system, if the equity principle is to be adequately taken into account.

In practice, the big bang approach to privatisation has had to compromise, no matter how reluctantly, when it met strong resistance from the public. Sometimes, it has gone to the other extreme. For example, the rapid privatisation programme in Russia, faced with the reality of poor tenants with very little savings, has been forced into granting ownership of residential units to them on very favourable terms. In many cases, these units are simply given away. This means that the government loses a source of future revenues, a prospect hardly helpful to the solution of the already serious fiscal crisis. In effect, the government has over-generously agreed to compensate the workers fully in one go. Moreover, such a *quick* move, which is apparently motivated by expediency rather than careful consideration of rights and obligations, would not occasion the kind of pressure on behavioural adjustment to the transition that the Chinese experiment could generate.

As we mentioned above, there are many other implicit contracts besides that for residential accommodation. The most difficult issue is the worker's implicit rights to the state enterprises, both in terms of ownership and management. Technically, the difficulty of rapid privatisation is recognised by most commentators, including many of those who advocate shock therapy. Borensztein and Kumar admit that 'conventional privatisation methods cannot achieve a large-scale privatisation in the current conditions of Eastern Europe' (1991, p.320). Several proposals on privatisation, namely those of 'vouchers', 'citizens shares', 'financial intermediaries', 'privatization companies' and 'self management' are considered, including their distributive consequences. Lipton and Sachs (1990B) also consider some variants of privatisation strategy and come out in favour of the mutual fund system, under which a small portion (10%) of shares is distributed to workers 'freely', but the majority are given to financial intermediaries. On the face of it, these authors seem to have broken new ground by looking at the issue of 'distributive' equity or justice in their proposals. In fact, the basis of distribution is arbitrary and this small 'gift' to workers is mainly intended to sweeten the big bang and reduce their resistance. The most egalitarian proposal put forward by a number of economists and officials in former Czechoslovakia—the vouchers system under which exchangeable vouchers are freely distributed to all adult citizens who can use them as points to bid for shares in the enterprises to the privatised—is rejected by both Borensztein and Kumar (1991) and Lipton and Sachs (1990B) for its failure to 'ensure market competition and an efficient method of management supervision' (Borensztein and Kumar 1991, p.324). Lipton and Sachs (1990B, p.297) also express explicit agreement with Kornai's (1990) emphasis that 'the privatization strategy should focus on establishing effective ownership and corporate governance, rather than on simply transferring nominal ownership to the private sector'.

Theoretically, such a perspective has its own merits. Without effective ownership and corporate governance, a 'private' enterprise system would not be able to operate efficiently. Nevertheless, it runs the danger of neglecting the implicit property rights of the workers, who would be cast aside in the process of systemic transformation. In practice, this idealistic prescription has not been heeded. In Russia, for example, a modified version of the voucher system was launched in October 1992, under which every citizen born before 1 September 1992 received a voucher with which she or he could bid for shares in privatising enterprises. The general rule was that these companies would reserve 35% of their equity to be sold for vouchers, but there were options whereby groups of employees could actually acquire majority share-holding. In a bid to privatise the economy rapidly, the vouchers were valid only for the period of thirteen months, although further tranches of them were planned (Djelic, 1992).

As far as the equity principle is concerned, it appears that even a uniform voucher system does not suffice. A stronger case can be made for a proportional arrangement under which all citizens are entitled to receive an amount of vouchers indexed to their work period under the old system. Moreover, taking both fairness and efficiency criteria into account, the exercise of their implicit property rights should not be imposed on them at a forced pace. This brings us back to Summers' critique of rapid privatisation for its lack of objective asset valuation criteria. If voucher-holders' rights are genuinely respected, they should be given enough time to assess the changing situation and make their bid. So an *extended* period of rights conversion is warranted. On top of this, a drawn-out process gives the population an opportunity to participate meaningfully in the evolution of the market economy in its various stages, instead of compelling them to make a few big decisions within a very short period, which could be quite alienating. Like the gradualist approach to housing reform, people are *involved* in the systemic changes and induced to adjust behaviourally to them.

Pushed to the extreme, a proportional voucher system would generate the 'ironical' result that the 'old guard' would have a dominating say in the transition. The intellectuals and the radicals, who in general are relatively junior in rank under this type of 'proportional democracy', would be relegated to the status of a vocal but ineffective minority. From the perspective of intertemporal equity in the context of systemic transformation, this also leaves much to be desired. After all, the traditional system has proved to the inefficient and requires major changes. One could therefore argue that the 'old guard' should not be fully compensated for their past doing: they need to be at least partially penalised for their incompetence. Leaving control in their hands may not augur well for the economic transition in terms of efficiency. On the other hand, it may be equally unfair to reward 'radical reformists' purely on the basis of their manifest intention to transform the economy. They have to justify the autonomy, power and trust that they receive in a give-and-take process.

The role of the state in the transition is therefore important: it has to arbitrate carefully between past moral obligations and emerging new norms. If I may venture a 'practical proposal', I would suggest as a benchmark that in the first stage of the transition, the state as an arbitrator should keep at least 51% of the control of any major enterprise that is to be privatised, while the rest (up to 49%) can be privatised under the proportional and exchangeable vouchers system over an extended period. The state may later sell its holdings of shares as the enterprise becomes more efficient and the valuation of its assets becomes clearer in the new economic environment, perhaps eventually making the firm 100% privately owned if circumstances warrant. In the process, the state should also be careful to preserve its own fiscal balance. All in all, it seems that a gradual process of privatisation is more desirable than a rapid one, if equity and efficiency considerations are to be appropriately taken care of, both in a backward-looking and in a forward-looking fashion.

3. The economic system as a complex structure

Implicit in many of the big bang supporters' assertions is the assumption that the constraints on the development of the free market in the CPEs have largely been artificially imposed by degenerate bureaucrats who call themselves Marxists. Rousseau's dictum rings loud, 'Men are born free, but everywhere they are in chains'. The chains once broken, the true men will rise and create a 'brave new world' of free spirits and free enterprises. This is obviously a one-sided view.

The transition is not a simple matter of breaking past bondage, as Gorbachev (1991) finally realised in his farewell speech. An economic system is an integrated whole composed of various parts which show significantly different adjustment speeds. To borrow an analogy well known in physics and systems theory (see e.g. Wilden, 1972), in any complex structure, some of the components can be characterised as 'slow-moving' while others are 'fast-moving'. Many other elements are of course 'medium-speed movers'. To hold the subsystems together, there must be a core mechanism which can effectively constrain the fast movers and speed up the slow movers, ensuring that the evolving structure would not face breakdown (Zhang, 1988). A social system is arguably even more complex and unstable than a physical system. Hence great care is needed with any systemic proposal. This basic institutionalist understanding is almost lost in the 'new classical counter-revolution' in Western economics which has swept the Western academic world since the late 1970s. Under the paradigms of rational expectations and instantaneous market clearing, the economic system looks more like a mental game, where everything moves at the speed of electronic waves, rather than a historically evolving institution of any concreteness and complexity.

Different economic variables indeed show different characteristics. Some, such as prices, are intrinsically fast movers. Provided the reformist leadership has sufficient courage, prices (which include commodity prices, service charges, interest rates, and exchange rates) can always be freed instantaneously. There are no technical difficulties involved. All that is required is an announcement and the implementation of the decision. Whether the resultant prices represent 'equilibria' or not is beside the point.

On the other extreme of the spectrum are elements that lamentably move at a snail's pace in the CPEs under reform: e.g. commercial culture and entrepreneurship, alleged signs of which the Western press never fails to eulogise whenever reporters spot a street-side bazaar off Red Square or near Tiananmen. Some liberals are so sceptical of the feudalistic tradition in China and Russia (which discriminates against the merchant class) that they wonder whether capitalism can ever develop on these soils.

Between these two extremes, one can easily locate examples of the 'medium-speed movers': legal-institutional frameworks of property ownership, enterprise management systems, and commercial practices etc. In this regard, the 1991 Nobel laureate in economics, Ronald Coase, was reported as pronouncing himself a sceptic of the experiment in Yeltsin's Russia (*Sunday Post*, Hong Kong, 15 December 1991). As the leading theorist in property rights, Coase was quoted as saying that it would take years to build the legal-institutional framework within which a normal market economy can properly function. By implication, to expect it to emerge from the ashes of a big bang would be foolhardy. Such a gradualist view is also echoed by Poznanski (1992), who argues for the superiority of a 'self-grown, evolutionary restoration of the capitalist economy' in Eastern Europe over that of a sudden state-led shake-up.

Other medium-speed movers also include the hardware and software of the market mechanism itself. In an earlier work (Tsang, 1990), I looked at the problem of establishing the market mechanism in a developing socialist country like China. Transportation, storage and distribution facilities are crucial hardware while efficient information flow (which is related to communication facilities and the 'maturity' of information disseminators and receivers) and possession of know-how on the setting up of the rules of the game are important prerequisites for establishing the necessary market software. Being a large rural economy struggling at a very low level of development, China is ill-equipped on all these counts. Together with other historical and institutional constraints, rapid decentralisation and liberalisation would only result in serious structural problems which might jeopardise the prospect of the reform itself—a diagnosis which I make of the Chinese economic scene in the period of 1985-1989.

It is not difficult to realise what would happen if an economic system with components that adjust at significantly different speeds is exposed to a big bang. Structural problems would invariably arise (Zhang, 1988). The slow movers will simply 'drag the feet' of the fast movers. Bottlenecks will inevitably form.

Imagine what would happen in a situation where prices are 'freed' while an efficient market fails to emerge and the reform in the ownership and management system of enterprises lags behind. Several possible consequences may arise. (1) The price elasticity of supply, constrained by institutional, structural and policy factors, is so low that the inflation rate will shoot up to unprecedented levels, seriously derailing production and generating extreme impacts on income distribution and people's livelihood. (2) The monopolists in the CPEs may simply get abnormal profits. They can use their 'market power' to implement price hikes and contribute directly to the upward price spiral, with no commensurate improvement in efficiency at all. (3) The non-monopolists will not be able to cope with the huge rises in production costs and will probably suffer huge losses. It is also unfair to ask them to handle a situation where prices of inputs suddenly go up by several hundred per cent and still achieve significant efficiency improvement. How many capitalist enterprises in the US and Western Europe can do that? These poor enterprises may be forced to lay off a large number of workers or drastically reduce their pay. Together, these phenomena may generate a serious situation of stagflation, which not only threatens the short-term prospects of the reform, but also the long-term growth potential of the economy.

In the last section, we explored the difficulties of rapid privatisation of property and assets in the transition largely from the perspective of equity. Here the issue is more technical; what about the fact that the privatisation process is by nature a much slower process than that of freeing prices? The problem is implicitly recognised but not explicitly addressed, that is to say, not directly incorporated into the shock therapists' strategy for the reform process which 'must be comprehensive'. Perhaps because of his deeper understanding of the reality in CPEs, Kornai has been much more forthcoming in expressing his worry about the conflict between the two processes. In *The Road to a Free Economy* (Kornai, 1990A), he makes it clear that, while he advocates the 'simultaneous' liberalisation of prices, introduction a freely convertible currency, 'restoration of budgetary equilibrium', and managing of macro demand so as to achieve 'the elimination of the shortage economy', he thinks that the ownership reform can only be 'gradual'. Unfortunately, instead of tackling the problem of widely differential adjustment speeds head on, he simply engages himself in abstract rhetoric, declaring on the one hand 'only a strong government can implement the economic policy outlined in this study', and rejecting on the other Pinochet and 'the Chicago boys surrounding him', not just for economic considerations, but also 'for *political and ethical* reasons' (Kornai, 1990A, p.206, original emphases). His political and ethical reasons are apparently quite different from those that I investigated above.

In his comments on a paper by Lipton and Sachs (1990A), Kornai's worry seems to have grown:

> [T]here are certain problems that have no solution, one of them being the efficient operation of a large state-owned sector...The second insoluble problem is that it is impossible to privatize in a 'big bang'. What to conclude? That for a long time, inevitably, a large part of the economy, in particular the gradually shrinking, but still rather large state-owned sector, will run inefficiently. This fact of life must be taken into account. If everybody is knowledgeable and works together, then this period may

> be relatively short. But should these countries be less fortunate and more divided politically, then the period of inefficiency may be very protracted...And while passive observation of what goes on would certainly be wrong, it seems that however energetically we may act, we cannot expect a quick, overnight solution of our problems. (Kornai, 1990B, p.142)

The realism is laudable. Unfortunately, it does not feed back into his thinking about the 'comprehensive reform strategy'. Criticisms against such a view could at least be launched at two levels:

(1) This view reflects an understanding of economic institutions and reality which remains patently abstract. It fails to grasp the concreteness of different economic variables that can only be changed, stabilised, nurtured and developed in different time frames and by different methods, as well as the dynamics of interactions among them. Both Lipton and Sachs (1990A,B) and Kornai (1990A) basically only look at two sets of variables: the 'stabilisation' variables (prices, the money supply, the fiscal deficit, the exchange rate etc.) and the 'systemic' variables (ownership and management) and merely treat the latter as constraints for the former. All the intermediate 'medium-speed movers' in the economic system are either completely neglected or only casually commented upon.

(2) At a more theoretical level, the big bang idea runs against the conventional wisdom of the theory of 'second best', which is well known in western economics. Pioneered by Meade (1955) and Lipsey and Lancaster (1956), and further developed by many others, the theory deals with the design of optimal policies for a 'distorted' economy where only some, but not all, of the distortions can be removed. Under that less-than-ideal situation, it is in general not optimal to resort to laissez faire or full-liberalisation policies ('first best' choices) in the sectors of the economy where distortions can be eliminated.

4. Concluding remarks

The analyses detailed in this paper against the implementation of a big bang in transforming a centrally-planned economy focus on several major institutional and systems considerations about the transition. They are by no means all-encompassing in scope.[1] Nevertheless, the arguments advanced here, covering both ethical and technical aspects, are intended to constitute an additional plea for caution against adventurism, which may arise from a revulsion towards traditional communism or from despair because many other alternatives appear to have failed in producing significant results. The moral is that any CPE should look very carefully before embarking on a 'great leap forward' as

[1] I have, for example, avoided the controversial issue of the feasibility and desirability of 'one-stroke macroeconomic stabilisation' as proposed by Kornai (1990) and practiced in different forms by Poland, Czechoslovakia (before it split) and Russia, among others, Relative success could be claimed for the first two countries although output loss had been considerable, while the 'surgery' in Russia was still in very bad shape by late 1993. Theoretical objection to such 'IMF-type' stabilisation strategy has been voiced by McKinnon (1991, 1992), and Podkaminer (1993) has shown by a mixed-integer optimisation model that any superficial equilibrium attained will be 'fragile'. The Chinese 'readjustment' programme in 1989-91 is, on the other hand, an example of how macro-stability may be restored less frenetically and at relatively low cost in terms of output and employment. The extent of price liberalisation in China in 1990-1994 was also remarkable. Essentially, the issue is one of cost and benefit. The optimal course of action is heavily dependent on the initial condition of the economy where macroeconomic stabilisation is to be implemented.

advocated by the 'shock therapists'. The theses on both the normative and positive economics of the transition are cast in a relatively broad framework. The position reached is explicitly partisan; moral and practical complexity points to a gradualist approach. Some of the analyses will certainly be contested. However, I hope that the debate can be carried out on a wider terrain.

Bibliography

Borensztein, E. and Kumar, M. S. 1991. Proposals for privatization in Eastern Europe, *International Monetary Fund Staff Papers*, vol. 38, no. 2

Charemza, W. W. 1991. Alternative Paths to Macroeconomic Stability in Czechoslovakia, Discussion Papers, no. 147, Department of Economics, University of Leicester

Chen, K., Jefferson, G. H. and Singh, I. 1992. Lessons from China's economic reform, *Journal of Comparative Economics*, vol. 16, no. 2

Djelic, B. 1992. Mass privatization in Russia: the role of vouchers, *RFE/RL Research Report*, vol. 1, no. 41

Fang, G. et al. 1990. *Macroeconomics of Public Ownership*, Shanghai United Press (in Chinese)

Fei, J. and Reynolds, B. 1987. A tentative plan for the rational sequencing of overall reform in China's economic system, *Journal of Comparative Economics*, vol. 11, no. 3

Gorbachev, M. 1991. *Resignation Statement*

Kornai, J. 1980. *Economics of Shortage*, North-Holland

Kornai, J. 1990A. *The Road to a Free Economy*, Norton

Kornai, J. 1990B. Comments on Lipton, D. and Sachs, J., Creating a market economy in Eastern Europe: the case of Poland, *Brookings Institution Papers on Economic Activity*, no. 1

Lipsey, R. G. and Lancaster K. J. 1956. The general theory of second best, *Review of Economic Studies*, vol. 24, no. 1

Lipton, D. and Sachs, J. 1990A. Creating a market economy in Eastern Europe: the case of Poland, *Brookings Institutional Papers on Economic Activity*, no. 1

Lipton, D. and Sachs J. 1990B. Privatization: the case of Poland, *Brookings Institution Papers on Economic Activity*, no. 2

Meade, J. 1955. *Trade and Welfare: Mathematical Supplement*, Oxford, Oxford University Press

McKinnon, R. I. 1991. *The Order of Economic Liberalization*, Baltimore, John Hopkins University Press

McKinnon, R. I. 1992. Taxation, money and credit in a liberalizing socialist economy, *Economics of Planning*, vol. 25, no. 1

Murrell, P. 1992. Evolutionary and radical approaches to economic reform, *Economics of Planning*, vol. 25, no. 1

Pickel, A. 1992. Jump-starting a market economy: a critique of the radical strategy for economic reform in the light of the East German experience, *Studies in Comparative Communism*, vol. XXV, no. 2

Podkaminer, L. 1990. Household under Quantity Constraints: Supply Multipliers in the Complete Model, with Implications for Transitional Macroeconomic Policy in Post-Communist Countries, mimeo

Podkaminer, L. 1993. Household Behaviour under 'Austerity' Stabilization of Hyperinflation: The Root of Fragility, mimeo

Popov, V. 1991. Soviet economic reform: possible difficulties in the application of public choice theory, *Journal of Comparative Economics*, vol. 15, no. 2

Poznanski, K. 1992. Market alternative to state activism in restoring the capitalist economy, *Economics of Planning*, vol. 25, no. 1

Qiu, Z. et al. 1992. *Renting and Purchasing Residential Accommodation*, People's University of China Press (in Chinese)

Sachs, J. 1992. The economic transformation of Eastern Europe: the case of Poland, *Economics of Planning*, vol. 25, no. 1

Schultz, C. 1990. Comments on Lipton, D. and Sachs J., Privatization: the case of Poland, *Brookings Institution Papers on Economic Activity*, no. 2

Summers, L. 1990. Comments on Lipton, D. and Sachs J., Privatization: the case of Poland, *Brookings Institution Papers on Economic Activity*, no. 2

Tsang, S. K. 1990. Controlling money during socialist economic reform: the Chinese experience, *Economy and Society*, vol. 19, no. 2

Tsang, S. K. 1992. Emerging trends in the Chinese economy after the 14th Party Congress, *Wide Angle*, Hong Kong, December (in Chinese)

Tsang, S. K. 1993A. Towards a System of Western-type Macroeconomic Control in China? paper presented at the panel *Trade and Economic Policies under Chinese Socialism*: *A Year 2000 Perspective*, 34th International Conference of Asian and North African Studies (ICANAS), August 22-28, Hong Kong

Tsang, S. K. 1993B. Financial disorder and macroeconomic reforms in China, *Hong Kong Economic Papers*, no. 23

Wilden, A. 1972. *System and Structure*, Tavistock Publications

Zhang, S. 1988. The Transformation in the Deep Structure of the Chinese Economy, paper presented at the International Conference on *The New Stage in China's Economic Reform* organised by the Hong Kong Social Sciences Research Society, Hong Kong, December (in Chinese)