Hungary and Mainland China (PRC):

A Comparison of Industrial Reform

Yu-Shan Wu*

ABSTRACT

The industrial reform in mainland China from 1984 to 1988 has brought about a property rights structure that is very similar to the Hungarian system. More than that, the two socialist countries demonstrate striking similarties in their overall developmental trajectories, basic orientations, origins of reform, preceding changes in agriculture, limits on reform policies, the costs and resistance, retrenchment, and the pressure for making the second wave of reform. In both countries, a unique set of elite values and perceptions interacting with similar politico-economic institutions led to a common reform pattern. The Hungarian experience suggests great financial problems for the regime in retrenchment, which forced it back to the reform track. A similar situation may well happen in mainland China, though the balance-of-payments and debt/austerity problems may exert much less weight on the Chinese Communist regime than they did in Hungary a decade ago. This means painful economic reforms will come only as a result of some financial functional equivalent of external economic crisis, or they may not come at all, and the country may stick to the status quo or slide back to a more controlled economic structure.

* Associate Professor, Department of Political Science, National Taiwan University

Between 1984 and 1988, by making an industrial reform that stressed marketization much more than privatization, mainland China (PRC) transformed its industry on the pattern of market socialism. This strategy brings its property rights structure in industry closer to Hungary than any other country in the world. Besides similarities in the concrete measures of industrial reforms, one can find resemblances between the two countries in their overall developmental trajectories, basic orientations, origins of reform, preceding changes in agriculture, limits on reform policies, costs and resistance, retrenchment, and the pressure for the second wave of reform. To be sure, there are differences accompanying these similarties, such as their sizes, degrees of economic development, and the international environments in which they find themselves. However, the overall patterns are so strikingly similar that one is inclined to juxtapose the two and explore into the causes of all the similarties①. This study will compare the prominent aspects of the Hungarian and the Chinese reform, and discuss the underlying political and economic causes. As will become clear in the discussion that follows, a unique set of elite values and perceptions interacting with similar politico-economic institutions led both countries into a common reform pattern. Since the Hungarians are the predecessors in this development, their experience indicates the structural pressure on the Chinese to conform to the pattern that they established. However, there are several interesting differences between the two that may lead the Chinese into alternative property rights structures.

Developmental Trajectories

Many Leninist regimes share the developmental pattern of starting

①Most recently, one finds a growing literature on comparative market reform in state socialism inspired by the similar experiences of Hungary and the PRC. See, for example, Balassa (1987), Hare(1988), and especially Stark and Nee (1989) who provided a theoretical framework for comparing economic institutions in reforming state socialism.

as a people's democracy and tolerating leftist parties as junior partners, then shifting to the high gear of totalitarianism and five year plans, and finally settling for some version of postrevolutionary authoritarianism②. However, there are great differences between the postrevolutionary regimes. Here the most important differentiate are the pattern of economic reform, the way in which the reform is introduced, and whether there is spillover from the economic to the political realm. When one looks at these issues and compare the trajectories of different Leninist regimes in their postrevolutionary stage, commonalities are replaced by differences in most cases. The Hungary-PRC pair is an interesting exception.

Both Hungary and the PRC had their united fornt period before moving into high totalitarianism. The adoption of the constitution (1949 in Hungary and 1954 in the PRC) marked the beginning of Stalinist politics and socialist transformation. Matyas Rakosi and Mao Zedong were the charismatic despots who enjoyed personality cult and ran the party-state in a dictatorial way. The First Five-Year Plan (1949—53 in Hungary; 1953—57 in the PRC) was characterized by collectivization in agriculture and heavy industrialization. Bottlenecks developed toward the end of this period. In the case of Hungary, the death of Stalin and the emergence of a new leadership in the Soviet Union forced Rakosi to step down from the premiership of the government and let Imre Nagy to adopt the "new course." In the PRC Mao Zedong pushed the already overstrained economy further by raising the "Three Red Flags," plunging the whole country into communistic economic campaigns. The disastrous results then forced Mao to retreat to the "second line," though maintaining his party chairmanship. Like Nagy in Hungary, State Chairman Liu Shaoqi and party Secretary General Deng Xiaoping took power and adopted "revisionist" policies

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②The most systematic exposition of the stage theory of Leninist development was made by Ken Jowitt (Jowitt 1975, 1983). Most scholars in comparative communism will at least agree that there is a historical shift from totalitarian to postrevolutionary regimes (Johnson 1970; Lowenthal 1970; Montias 1970).

to salvage the national economy. Emphasis was put on agriculture and light industry. The country was temporarily relieved.

The "revisionist" policies were in effect for only a short period of time. Rakosi made a comeback in 1955. Though Nikita Khrushchev's denunciation of Stalin at the Twentieth Congress of the CPSU in 1956 tilted the balance of power in Hungary, forced out Rakosi, and resulted in the second Nagy regime, the Hungarian revolution that followed was swiftly put down by the Soviet troops. Janos Kadar became the First Secretary of the party and put Nagy and his entourage to death. Not until the Eighth Congress of the Hungarian Socialist Workers' Party (HSWP) convened in November 1962 was there any sign of political relaxation. The second wave of totalitarianism occurred in the PRC when Mao launched the Great Proletariat Curltural Revolution at the end of 1965. Liu was tortured to death and his policies abolished. Class struggle dominated political scene until Mao's death in 1976 and Deng's ascendancy at the Third Plenum of the Eleventh Central Committee at the end of 1978.

Political and economic pragmatism finally dominated both countries after the second wave of totalitarianism. Class struggle was put to rest and economy was in command. The paramount leader who led the transformation was Janos Kadar in Hungary and Deng Xiaoping in the PRC. Kadar was a major lieutenant to Rakosi when he headed the Ministry of the Interior and took charge of the show trials in the heyday of the totalitarian rule. He then was victimized by the despot and suffered torture in jail from 1951 to 1954. Deng was the Secretary General of the Chinese Communist Party (CCP) and was instrumental in Mao's purge of the nation's intellectuals in the Anti-Rightist Campaign in 1957. Deng was later accused of being a "capitalist roader," and was subject to all kinds of humiliations during the Cultural Revolution. Both Kadar annd Deng were totally disillusioned with the ideology but remained authoritarian in terms of the party's political control of the country. Under their "enlightened authoritarian" rule, political campaigns subsided, the economic realm was depoliticized, and major economic reforms were launched. The legitimacy base of the party-state was decisively shifted from ideological claims to material benefits.

The economic reform began in agriculture. The purpose was to satisfy the most basic needs of the population. The Hungarian approach was distinctively market socialist, whereas the Chinese reform verged on quasi-privatization. But in neither case was there a transfer of ownership. The agricultural successes prompted the reformers to introduce the reform pattern into the cities. On January 1, 1968, the New Economic Mechanism (NEM) was put into effect in Hungary, and the Third Plenum of the Twelfth Central Committee of the CCP passed the "Decision on Reform of the Economic Structure" in October 1984. Both industrial reforms created a limited and guided market with the socialist ownership of the means of production basically intact. The Hungarian NEM ran smoothly for five years before the blue-collar workers made strong protests against their deteriorating position in income distribution. Kadar sided with the workers and reversed the trend of reform in November 1972. Hungary thus moved into retrenchment until seven years later when the trade imbalances and mounting foreign debts forced the country back on the track of reform. In the case of the PRC, it was unprecedented inflation and an ill-timed price reform that forced the regime to start retrenchment in September 1988. Whether macroimbalances will lead the country toward a second wave of reform remains to be seen.

By juxtaposing the trajectories of Hungary and the PRC since the founding of the people's republics one sees striking parallels not only during the stage of high totalitarianism, but also in the postrevolutionary developments. These are not simply superficial resemblances, but are rooted in a common set of elite values and perceptions, interacting with similar politico-economic institutions. In order to look into the dynamics of these developments, one needs to examine the specific aspects of the two reforms.

Basic Orientation

The industrial reforms of Hungary and the PRC were embedded in "socialist enlightened absolutism"③. This is the ruling philosophy of the postrevolutionary regimes that seek to restore their legitimacy by improving the living standards of the population on the one hand, and retaining monopolistic political control on the other hand. As far as politics is concerned, people are no longer required to fervently participate in political campaigns, as in the heyday of totalitarianism. Their major responsibility is now to accept the enlightened rule of the reforming elites. Radical economic reforms are undertaken, usually flying in the face of Marxism-Leninism. The economic realm and the political realm are carefully separated, so that no reform dynamism will overspill into politics. The only political changes made are to purge conservatives who are against the economic reform within the regime and to reduce the role of the party in managing the economy. These measures are to facilitate the economic reform, not to democratize the political process.

In Hungary, "socialist enlightened absolutism" first took the form of Kadar's "alliance policy," announced in June 1957, at the first conference of the newly organized HSWP, but not implemented until afterthe Eighth Congress in 1962. This policy changed the pre-1956 Party slogan representing the concept of class struggle--"Whoever is not with us is against us" to "Whoever is not against us is with us." Any public office could then be held by a non-Party person without regard to family background, past activity, or personal philosophy, as long as he or she had the necessary qualifications and was willing to contribute to socialist construction (Toma and Volgyes 1977, 15). After the announcement of the "alliance policy," Kadar nevertheless had to fight a battle against the dogmatists in the Party and was able to impose his will only after Nikita Khrushchev's victory over the Soviet hardliners at the Twenty-second Congress of the CPSU in October 1961. With the consolidation of his power at the Eighth Congress in 1962, Kadar

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③The term "socialist enlightened absolutism" was coined by Wlodzimierz Brus, a famous Polish economic reformer, in his discussion of Kadarism (Brus, 1980, 50).

was then able to set in motion a trend of political relaxation that reduced the number of forced labor camps, released political prisoners, abolished the system of internal exile and internment without trial, purged the political police (AVH), relaxed travel restrictions and put an end to the jamming of Western radio stations (Gati 1974, 24; Toma and Volgyes 1977, 14). The Eighth Congress signified the end of class struggle and shifted national attention to economic construction. From this time on, economic reform became the centerpiece, the *ultima ratio* of the alliance policy (Kovrig 1987, 118).

The signs of political relaxation under the "alliance policy" should not be confused with pluralism and democracy. Even though there were limited electoral reforms since 1966, the leading role of the Party was never to be questioned④. The persecutions of intellectuals and writers holding different views form the Party testified to the authoritarian nature of Kadar's rule⑤. The New Economic Mechanism was contemplated and implemented by the regime on the advice of a group of reform economists, without consultation with the public. The economic liberalization was carefully kept from overspilling into the political

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④ The new electoral law of 1966 permitted multi-candidate elections and broadened the process of nominating candidates to include nominations from organizations other than the local party cells. By 1971 in 49 out of 352 electoral districts, there were two candidates on the ballot, giving 15 percent of the population a choice (Volgyes 1973, 217).

⑤ In 1972, Andras Hegedus, Agnes Heller and Mihaly Vajda were expelled from the party and dismissed from their jobs in the Hungarian Academy of Sciences because their views on modernization were identified with both "petty-bourgeois revisionism" and the New Left. In 1973 and 1974, writer Mikols Haraszti was tried on charges of slandering the state and falsifying conditions in a tractor factory, the locale of his novel *Darabber* (Piecework). In 1974, sociologists Gyorgy Konrad and Ivan Szelenyi were arrested and harassed because of their views about the processes of development the state would follow in the future. As a result, Szelenyi was "advised" to emigrate to the West (Volgyes 1976, 107; Gati 1974, 24).

realm (Volgyes 1976, 107). There were reform measures aimed at removing management of enterprises from the purview of party hacks, but these policy changes were administrative in nature and served to boost managerial authority vis-a-vis the workers. The regime followed a deliberate policy of depoliticization of its citizens, not only in the sense of discontinuing political campaigns, but also in the sense of discouraging genuine political participation. What Kadarism cultivated was a "subject culture" (Almond and Powell 1978, 35) that did not force, nor allow, the population to participate in the political process, but instead encouraged passive acceptance of the enlightened rule of the reforming elites.

Deng's political dominance was assured at the Third Plenum of the Eleventh Central Committee in December 1978, but his victory over the leftist remnants of the Cultural Revolution (as represented by Hua Guofeng) was not complete until 1981⑥. At the Sixth Plenum of the Eleventh Central Committee in June 1981, a historical document on the Party history was passed which proclaimed the end of class struggle, the need to emancipate the mind and seek truth from facts, the insistence on the leadership of the Communist Party, and the paramount goal of economic construction.⑦These statements translate to political

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⑥ Hua resigned from premiership at the Third Session of the Fifth NPC in September 1980, and resigned from Party chairmanship as well as chairmanship of the Party Military Commission at the Sixth Plenum of the Eleventh Central Committee in June 1981.

⑦The document was the "Resolution on Certain Questions in the History of Our Party Since the Founding of the People's Republic of China." It severely attacked Mao's theory of "continued revolution under the dictatorship of the proletariat," claimed that there were no grounds at all to define the cultural revolution as "a struggle against the revisionist line or the capitalist road," urged "emancipating the mind" and "seeking truth from facts," upheld the four fundamental principles: "the socialist road, the people's democratic dictatorship, the leadership of the Communist Party, and Marxism-Leninism and Mao Zedong Thought," and declared "After socialist transformation was fundamentally comrelaxation, authoritarian rule by the Party and economic reform, the defining features of "socialist enlightened absolutism." The 1981 Plenum of the CCP is comparable to the Eighth Congress of the HSWP in that a powerful statement was made for political relaxation and economic reform, as signified by the Resolution and the elimination of Hua Guofeng. Under the liberal policies of Deng and Party Secretary General Hu Yaobang, the Chinese "alliance policy" took the form of removing political labels (such as "rightist," "counterrevolutionary," "bad element," and the like) and rehabilitating millions of political pariahs, estabishing a rudimentary legal framework, holding multi-candidate elections, allowing more intellectual freedom, and relaxing travel restrictions (Harding 1984c).

As in the Hungarian case, political relaxation should not be confused with democratization. Whenever there were signs of political challenge to the Party's absolute rule, Deng sided with conservatives to crack down. This was the case in the criticism of writer Bai Hua in 1981, the Anti-Spiritual Pollution Campaign in 1983, the Anti-Bourgeois Liberalization Movement in 1987, and the bloody suppression of the student demonstrators in Tiananmen Square in 1989. In the last two cases, Deng showed a strong revulsion against mass politics and a high preference for "subject culture" that partially reflect his experience with the Red Guards during the Cultural Revolution. Deng went so far as to remove two of his successors--Hu Yaobang (1987) and Zhao Ziyang (1989) as he tightened political control, but he never failed to stress the importance of economic reform at the same time. This painstaking separation of politics and economy, and the insistence on applying different principles to the two realms suggest the duality of Deng's approach (Chang 1989) which is the essence of "socialist enlightened absolutism." There were times when the regime

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pleted, the principal contradiction our country has had to resolve is that between the growing material and cultural needs of the people and the backwardness of social production," and "All our Party work must be subordinated to and serve this central task--economic construction (*Beijing Review*, 6 Jul 1981, 10–39)."

talked about political reforms, but these were mainly administrative measures aimed at reshuffling personnel and restricting the Party's role in the economy (Luo 1986). The major purpose of these measures was to provide a political environment amicable to the economic reform.

The Origins of the Industrial Reform

"Socialist enlightened absolutism" ended class struggle and shifted the regime's attention to economic constrution. In order to understand how this basic orientation was translated into concrete reform measures in the Hungarian and Chinese industry one needs to take a look at the common origins of the two industrial reforms: the traumatic imprinting event, the victimized leader, the requirements of consumption-oriented and intensive growth, and the success in the preceding agricultural reform.

Both Hungary and the PRC experienced a traumatic imprinting event after the Communists took power: the suppression of the 1956 uprising in Hungary and the Chinese Cultural Revolution. These events destroyed the ideological righteousness of the regime and brought a totally disillusioned population, a fact the ruling elites were keenly aware of. Unable to claim regime legitimacy in the old way, the leaders were forced uo rely on the universal legitimating mechanism: improvement of the people's living standards. To a certain extent this shift of legitimacy base from ideology to economic performance was true of all postrevolutionary regimes in the socialist countries, but the frank acknowledgement of the attenuated regime legitimacy and the single-minded pursuit of consumption-oriented development were no where more obvious than in Kadar's Hungary and Deng's China (Kovring 1987; Deng 1984). The historical traumas thus led to a fertile ground for radical economic reforms.

Not only were the population traumatized by the past, the leaders were also victimized. Janos Kadar was the Minister of the Interior under Rakosi and was responsible for the show trials of, for example, Jozsef Mindszenty and Laszlo Rajk. His internment between 1951 and

1954, however, changed his political beliefs and turned him into a pragmatic politician keenly aware of the excesses of charismatic despotism (Gati 1974). Even though he deserted Nagy and went to join the Soviet-supported Revolutionary Workers' Government in 1956 before the Soviet intervention and was chosen by Moscow as the HSWP's leader after the suppression, his disillusionment with the dogma and his pragmatism toward economic reforms gradually became obvious as he announced the alliance policy, purged the hardliners from the Party, and implemented the New Economic Mechanism. Deng Xiaoping had a similar experience in first being Mao's major lieutenant in the 1957 Anti-Rightist Campaign ⑧ and then being purged and humiliated together with liu Shaoqi during the Crltural Revolution as "capitalist roaders." Even though Deng chanted revolutionary slogans after his rehabilitation in 1973, his major goal was to help Premier Zhou Enlai in promoting Four Modernizations, which caused his rift with the Gang of Four and resulted in his purge after the 1976 Tiananmen incident. Deng's second rehabilitation in 1977 and his political ascendance since the end of 1978 gave him the best opportunity to implment his reformist policies. The dramatic fluctuations of Deng's political career has turned him into a pragmatist par excellence and made him capable of defying dogma and promoting economic reforms. Like Kadar, the past experience thoroughly removed the ideological constraints on this first generation Communist leader who was then in a position to contemplate and implement radical economic reforms.

With the improvement of the people's living standards perceived as the only way to rebuild legitimacy and with maximum flexibility on the part of the elites to change the economic structure, the regime is

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⑧Deng was the Party General Secretary in 1957 and made the report on the Campaign at the Third Plenum of the Eighth Central Committee in September of that year in which he claimed that the thought transformation of the Chinese intellectuals would take ten more years (Chang 1989, 31). His attitude toward the Campaign has not changed since his second rehabilitation in 1977 (Deng 1984, 279).

nevertheless left with the question of what kind of economic reform is needed to achieve its objectives. The pre-reform economic structure in Hungary was a typically Stalinist command system with its priorities set on high investment and heavy industrialization. The old Maoist system was also built on a commannd hierarchy with similar priorities and was infused with a strong dose of egalitarianism, a disdain for material incentives, and an obsession with provincial self-sufficiency (Harding 1987). As far as the postrevolutionary elites of the two countries were concerned, the major defects of the old system were stagnant consumption and sluggish growth⑨. The primary tasks then would be to shift national resources from accumulation and heavy industry to consumption-oriented development, and to improve efficiency at a time when easy sources of growth had been exhausted and increased productivity was the major remaining source which would have to be tapped if growth was to continue (Hewett 1980, 520).

The two reform tasks can be tackled by two strategies. The first strategy would command a shift of resources from investment and heavy industry to agriculture, light industry, and services. It would also make administrative and technical reforms within the command system to improve its efficiency. The second strategy would introduce market as the main resource allocator so that profit-maximizing enterprises would produce more consumer goods to satisfy popular demands. It would also rely on market to generate competition among enterprises and force them to be more efficient. The first strategy is to perfect the planning system, whereas the second one is to

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⑨A difference between the economic difficulties that the two countries faced before the reform began was that Hungary, being a small and trade dependent country, had developed balance of payments problems that had to be resolved, whereas China, after decades of economic autarky, was much less vulnerable to trade imbalance (Hare 1988; Nyers 1983).

replace plan with market⑩. All postrevolutionary regimes in the socialist had tried the perfecting strategy to a more or less extent, but Hungary and the PRC (together with Yugoslavia) were distinct in adopting a marketization program. However, marketization, or delegation of the control power, shall not be confused with privatization, or delegation of the income power. The marketizing strategy, however radical it may appear against plan perfection, is still short of a transformation of the ownership structure. What the elites were aiming at was a version of market socialism, with public enterprises competing on liberated, though not totally free, markets. It was assumed that this hybrid model would improve the people's living standards by shiting national resources to satisfy consumer needs and increasing productivity, while maintaining the party-state's ultimate claim on the means of production.

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⑩ Similar distinctions were made by Morris Bornstein (1977), Tamas Bauer (1977–78), and Jan Prybyla (1990). The forerunner of the marketization reform was Yugoslavia in the 50's. Then came a redistribution of resources to the consumption sector (not to the extent of overtaking heavy industry) in the immediate post-Stalin period in whole Eastern Europe, followed by administrative reforms in the GDR, the Soviet Union, and Bulgaria in the 60's. In the late 60's Czechoslovakia and Hungary launched similar marketization reforms. The Prague Spring ended abruptly because the Czechoslovak reform overspilled into the political realm and went beyond what the Soviet Union could tolerate. The 70's witnessed more administrative and technical reforms, such as the GDR's *kombinate* (Koziolek 1987–88), but primarily heavy borrowing by East European countries as a substitute for domestic reforms and accumulation of huge foreign debt, though marketization gained an additional stronghold in the PRC at the end of the decade. The international financial crises in the early 80's engulfed all the debt-ridden countries in Eastern Europe, and forced them into austerity, without changing the established patterns of perfecting vs. marketizing that these countries had been following, Finally, the democracy movement that swept the Soviet Union and Eastern Europe in 1989 set in motion radical economic reforms that aim not only at marketization, but privatization.

The reform was started in agriculture in both countries in order to satisfy the most basic needs of the population. In 1965 the Hungarian reformers began to decentralize the newly recollectivized agriculture⑪ by dropping obligatory plan targets except in grain production. Further marketization reforms, heavy investment, and subsidies led to a successful agriculture in terms of abundant self-sufficiency, prominent export of farm products, introduction of new technology, acceptable income distribution, and high labor and land productivity. There was a small efficient private sector in symbiosis with the dominant socialist realm. In general, the Hungarian market socialist reform proved capable of meeting the elite's objectives to improve the people's living standards while preserving the socialist character of the ownership structure (Marrese 1983; Csaki 1983). The apparent success of the agricultural reform then became the main reason for the decision to take similar initiatives in the industrial sector (Hare 1988, 57).

The PRC's economic reform also began in agriculture. Since 1979 measures have been taken to transfer both the control and income power to the households. The "household responsibility system" gradually gained dominance as a result of spontaneous actions at the local level and subsequent approval from Beijing. The new system allots a certain amount of land to an individual household on a long-term basis with the family to receive all income from the land after meeting certain obligations to the collective and the state. In June 1982, the household responsibility system had spread to 86.7 percent of all the production teams, and in January 1983, a uniform policy was

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⑪ The Hungarian agriculture was collectivized during the First Five-Year Plan period (1949–53). The following two Nagy governments (1953–55, 1956) reversed the trend by making membership in agricultural cooperatives voluntary. The 1956 uprising and its aftermath produced severe settbacks for collectivized agriculture with 63 percent of the cooperatives dissolved in November and December of that year. A recollectivization campaign was launched between 1958 and 1961. By 1962, 92.5 percent of Hungary's arable land was in the socialist sector (Marrese 1983; Toma and Volgyes 1977, 17).

announced to officially install the new system at the national level. In 1985, a decision was made to abolish the three-decade-old compulsory procurement system and transfer full control power to the households. The only remaining limit on the households' property rights was their limited tenure. The PRC's rural reforms thus brought about a decollectivization and quasi-privatization of its agriculture (Perkins 1988; Harding 1987). As in the Hungarian case, the successful agricultural reform created pressure to introduce reform measures in industry (Goldman 1987, 244–45).

Both Hungary and the PRC had successful agricultural reforms before they plunged into a comprehensive urban-industrial reform⑫. But while Hungary's collective agriculture thrived on the principle of market socialism, the PRC's household responsibility system was from the very beginning a move toward both marketization and privatization (Yan 1989)⑬. Indeed the thorough transfer of the income power to the households was the earmark of the Chinese agricultural reform. Thus when the rural pattern was transferred to the cities with the reform focus shifting to industry, the Hungarians and Chinese had different referent experiences in agriculture. As a result, the Hungarians tended

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⑫ As a result of these successes, a prosperous kulak class emerged in both countries. In the mid 70's, more than 30 percent of the active and working peasantry in Hungary earned more than 10,000 forints per month per household, entitling them to memberships in the new "middle class (Volgyes 1976)." Similarly, a group of *wanyuanhu* (ten thousand yuan household) emerged in the PRC after the agricultural reform.

⑬The Hungarians did not decollectivize their agriculture, but modified its property rights and put in heavy investments (Marrese 1983). Their Chinese counterparts, however, dramatically cut state investment in agriculture and depended on a more radical property rights reform to stimulate agricultural production. The one-time stimulus provided by this radical institutional change peaked in 1984 when a record grain harvest was registered, which was followed by years of drops in grain production as the state failed to provide sufficient factors of production for agriculture (Fewsmith 1988).

to stick to the principle of market socialism, i.e. marketization without privatization, to a greater extent than the Chinese, who tinkered with privatization proposals and various ownership forms shortly after marketization measures proved unable to solve their economic problems in industry.

The Content of the Industrial Reform

The basic principles in the Hungarian NEM of 1968 were the same as those embodied in the CCP's October 1984 "Decision on Reform of the Economic Structure." Both abolished the central allocation of materials and products as a system, and replaced plan with market as the major allocator (Bauer 1983). The managers were granted the control power to make production and exchange decisions. This being said, one still find four sets of constraints on the enterprises that prevented them from behaving like their counterparts in a capitalist economy. These constrains are: state ownership, circumscribed markets, monopolies, and economic regulators-levers⑭.

In general, the reformers in both countries stuck to the principle of market socialism, i.e. marketization without privatization. They were both interested in preserving the state's role as the dominant owner of the national economy. Since privatization was excluded as a means to provide the penalty-reward system for the enterprises, the state was forced to simulate its effect by linking enterprise profits, retained profits and presonal rewards together through complicated formulate. These formuae were designed and implemented by economic bureaucrats and were subject to change. Goals other than improving motivational efficiency, such as equitable distribution of enterprise profits, workers' job security, and control of inflation were simultaneously pursued through the same formuae. This soft and multi-functional nature of the incentive structure led to vertical bargaining between the managers and the bureaucrats on the one hand, and reduced attention to the market signals on the other hand.

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⑭For a thorough discussion, see Yu-Shan Wu 1990.

The major difference between the Hungarian NEM and the Chinese economic structural reform resides in their different attitudes toward marginal privatization. In both cases a successful agricultural reform preceded, informed and prompted the following industrial reform. But while Hungary's collective agriculture thrived on the principle of market socialism, the PRC's household responsibility system was from the very beginning a move toward both marketization and privatization. The common strategy of transplanting the rural reform pattern to the cities thus meant different emphases in the two countries with the Chinese reformers taking a more lenient attitude toward mixed and private ownership forms. Another important reason for this divergence in attitude was based on the difference in relative resource endowments between the two countries. The PRC is labor abundant and its industry has difficulty in absorbing the surplus labor released from agriculture as the reform improved its efficiency (Hare 1988, 61). *Getihu* (small private businesses) and later on *siying qiye* (private enterprises) were tolerated, legalized, and ultimately protected by the 1982 constitution and a 1988 constitutional amendment partly because they provided employment for the displaced peasants. The situation in Hungary was entirely different. Even though the reformers were initially worried that the NEM might create unemployment problems as enterprises tried to lay off unnecessary workers, the subsequent development showed that full labor employment was achieved in Hungary and that the country was facing labor shortage, not unemployment (Portes 1970; Kornai 1986a). Without the need to tolerate unorthodox ownership forms to absorb displaced labor, the Hungarian reformers did not touch on the issue of privatization in their first wave of industrial reform from 1968 to 1972. In stark contrast, the ownership reform was in vogue in the PRC shortly after the guidance planning of 1984–85 created an overheated economy (the toleration of *getihu* began much earlier in 1982), and the reform pendulum basically swung between marketization and privatization in the first wave of the Chinese industrial reform from 1984 to 1988. In Hungary, even though the second economy and the black market were such prominent phenomena in the society, the regime did not begin to incorporate them into the formal sector until 1982, fourteen years after the NEM was introduced, and not without a retrenchment interlude between 1972 and 1978 (with a campaign against private businesses in 1975) (Kovrig 1987). In short, compared with the Chinese, the Hungarians had a more conservative attitude toward privatization⑮.

Even though the industrial reform brought about marketization in both Hungary and the PRC, the markets that emerged were carefully circumscribed. The reformers preserved large territories for plan where the state commanded the enterprises in the old way. In Hungary this market circumscription was necessitated by its role in the Council for Mutual Economic Assistance (CMEA). In order to trade with other socialist countries sticking to central planning Hungary had to retain direct control over the sectors that fulfilled CMEA delivery obligations. This control then extended into areas supposedly covered by market principles. In the PRC a two-tier system was created that

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⑮The overdue ownership reform in Hungary in the 1980's produced an array of ownership forms for which one can easily find counterparts in the PRC. There were private small-scale enterprises in service and manufacturing, and retail shops leased or contracted out to private individuals. But one can also find uniquely Hungarian phenomena such as the Enterprise Business Work Partnerships (EBWPs). The EBWPs are groups of workers subcontracting a part of the parent enterprises' operations. They use enterprise assets and materials, pay a fee for them, and keep the rest of the profits (Prybyla 1986). This innovation coops the widespread illegal activities of workers using enterprise facilities during regular work hours for private benefits. It also bypasses the wage restrictions designed by the state to prevent extravagant use of wage increases and bonuses associated with soft budget constraints. Most important of all, however, is the fact that the EBWPs create a part-time contract-responsibility system (using the Chinese term) within the socialist enteprises. The EBWP members are normal workers during regular hours and subcontractors after work. This suggests a more cautious move toward ownership reform than what one observes in the PRC.

carefully separated the market and plan realms. The purpose of this system was to reduce the shocks of transition as the economy shifted from the old to the new structure, to "change a big earthquake into several small tremors (Wu and Zhao 1987)." As the line between the two realms was drawn not on product, i.e. certain products would be governed by plan, others by market, or on enterprise, i.e. specific enterprises would produce goods under plan directives, others would follow market signals, but on *quantity*, i.e pre-fixed quotas must be delivered to the state, with the above-quota outputs at the free disposal of the enterprises, one finds the same enterprises producing the same goods for different realms. Since price differences always exist between the plan and market sectors, an irresistible temptation was created for the managers (who had been turned into profit-maximizers) to take advantage of this situation by shifting materials and products from the plan realm to the market realm. As a result, the plan was disturbed, the market was distorted and a hotbed was createed for official profiteering (*guan dao*) (Wu and Zhao 1987) that caused such a public outrage as had never been seen in Hungary.

Both Hungary and the PRC introduced price reform as they began to reconstruct their industry. But the emerging pricing system was a distorted one, prone to inflation as a result of its monopolitic structure. The Chinese enterprises gained monopolies mainly through regionalism, i.e. local governments protecting their markets against the incursion by enterprises from the outside. The Hungarian functional equivalent of the Chinese regionalism was its industrial structure. If one takes a look at the track record of the Hungarian price reform, it is clear that the monopolistic structure of the market constituted a major block to competitive prices once the administrative control had been lifted. Hungry had one of the most highly concentrated industrial structures in the world as a result of decades of conglomeration. In fact, in order to retain control over individual enterprises, the state effected a series of mergers in 1967 right before the reform started which drastically reduced the number of enterprises (Buky 1972). The result was an industrial structure shaped like a pyramid turned upside down, characterized by a preponderance of big enterprises and a significant lack of small and medium ones (Ehrlich 1985). The first wave of industrial reform witnessed a partial liberalization of the pricing system that created three categories: state-fixed prices, maxima (roof) prices, and free market prices. The monopolistic enterprises then took advantage of their market positions by raising prices to maximize profits. As the NEM liberated producer prices more than consumer prices⑯, a strong inflationary trend was generated throughout industry. With producer prices rising, the state subsidized consumer industries in order to prevent the inflationary prices from being passed onto the general populace (Buky 1972, 34). Wage control was also strengthened to suppress demand. The common lesson from the two countries is that price liberalization does not automatically lead to a competitive market, as enterprises holding monopolistic positions try to maximize their profits through raising prices, not improving efficiency.

The final set of constraints imposed on the enterprises operating on the Hungarian and Chinese socialist markets were the economic regulators-levers⑰. These were the financial instruments bearing on the profit prospects of the enterprises that the state manipulated to guide the profit-maximizing behaviors of the managers. They included prices, taxes, credits, grants, interest rates, etc⑱. The state man-

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⑯ Of total interenterprise turnover of raw materials and semifinished goods for 1968, about 30 percent was transacted at fixed prices, 40 percent at prices subject to maxima or other limits, and 30 percent at free prices. The corresponding figures for producer prices of finished goods were 3 percent, 19 percent, and 78 percent; for consumer prices, 20 percent, 57 percent, and 23 percent (rose to 30 percent in 1969) (Portes 1970, 308).

⑰ What the Hungarians called "regulators," the Chinese called "levers" (*ganggan*).

⑱ In the Hungarian case, part of these remaining state controls were considered "brakes" that permitted central authorities to intervene in the economy in order to stave off economic and political upheavals, and then to be released as the reform progressed. In fact, the brakes were not released in 1971 as promised. On the contrary, central intervention was increased toward the end of the first NEM reform.

ipulated these insruments to guide the enterprise behaviors in an indirect way. Since the economic bureaucrats had the discretionary power to apply these regulators-levers on an enterprise-specific base, little wonder the managers bargained with them to seek favorable treatments. Instead of maximizing profits "in the real sphere," the enterprises devoted much effort to maximizing concessions from their bureaucratic supervisors "in the control sphere (Kornai 1986b)."

The existence of the economic regulators-levers was the most serious challenge to the principle of market socialism. This was the case because whereas circumscribed markets and monopolies were either necessary measures to stablize the external economic relations, transitional policies to reduce shocks created by the reform, or unintended results from delegating the decision-making power, the strategy of "the state regulates the market, the market guides the enterprises" was a shrined reform philosophy in conflict with the very notion of true marketization. The idea was to create autonomous firms that would respond to market signals vigorously and put into the hands of the central policy makers all the instruments of indirect control. The state then pulls the strings and the profit-maximizing agents respond like obedient puppets. In this respect, there was no difference between the NEM reformers in Hungary and their Chinese counterparts in the early 1980's. Based on this observation, Janos Kornai refuted Richard Portes' claim that the Hungarian reforms "do make the basic change from a command economy to a socialist market economy (Portes 1970, 307)," and insisted that the reforms simply shifted the Hungarian system from one under direct bureaucratic contorl to indirect bureaucraic control (Kornai 1986a, 1701). This being said, one cannot deny the fact that the thrust of reform in the two cases was toward market socialism, even though what emerged was a limited and guided socialist market.

The Suspension of the Reform

In Hungary and the PRC, with the major legitimacy base of the regime shifting from ideology to the people' material well-being, the pragmatic leaderships adopted a marketizinng strategy to channel national resources to consumer goods and create a competitive enviro-ment to improve efficiency. However, socialist marketization had serious trade-offs in terms of the material benefits that the regime used to provide under the old system.

The most palpable benefits which socialist central planning brought to Hungary and the PRC were stable prices for consumer goods (and subsidized prices for necessities), a relatively flat income distribution, and guaranteed full employment. These were the major principles in the socialist ethics (Kornai 1986b). The policies pursuing these principles always had their costs in terms of lost efficiency in the utilization of productive factors and waste of many products (Hewett 1980). Consumer prices frozen at low levels were based on government subsidies and were unable to send right signals to the market. Flat income distribution dampened the incentives for work. Job security, especially in the version of keeping everyone's current job, excluded the possibilities of bankruptcy and shift of labor to more productive activities. As a result, the penalty-reward system was weakened and the price signals were rendered meaningless. Both motivational efficiency and allocative efficiency were sacrificed. After the industrial reform, the regime's marketizing stratgy emphasized efficiency, inevitably at the expense of the socialist ethics. To be sure, not all the principles of the soclalist ethics were challenged to the same degree by the reform. Job security, being the most fundamental aspect of the socialist welfare network, was more verbally threatened than actually undermined. In Hungary, the closing-down of plants was not contemplated when the NEM was introduced (Balassa 1978, 260). Although toward the end of the first-wave reform, in 1971 and 1972, Jeno Fock (Prime Minister) and Rezso Nyers (Party secretary in charge of economic affairs) made repeated arguments for "eliminating unprofitable production," and "regrouping labor (Portes 1977, 786-87)," these threats never materialized as the November Plenum of 1972 registered a major retreat from the market reform. In the PRC, the

Bankruptcy Law was removed from the agenda of the National People's Congress several times, mainly owing to the strong opposition from the conservatives led by Peng Zhen, the Chairman of the Standing Committee of the NPC. When the Law was finally put into effect on November 1, 1988, the regime had already made the decision to halt the reform at the September Plenum of that year. It was true that in both countries one could find individual cases of bankruptcy, but these were rare exceptions. In short, bankruptcy was not put on the agenda until toward the end of the first-wave reform, and it was swiftly brushed aside.

The remaining two issues of the socialist ethics, i.e. price stability and egalitarian distribution, were tackled by the reformers in the two countries, though in very different ways. The Hungarians were highly sensitive to the inflationary pressure that the reform could create, and took successful measures in controlling consumer prices, mainly through a tight wage control. At the same time, they were keenly aware of the incompatibility between efficiency and equality, and took a distributional policy that strongly favored the managerial class vis-a-vis the workers. However, they failed to correctly gauge the discontent of the blue-collar workers who resented their deteriorating position in the national income distribution. The trade unions then allied themselves with the conservatives to stall the reform. The PRC, on the other hand, failed to put into their reform package any serious measures of wage control. The result was less working class discontent but stronger inflationary pressure generated by extravagant wage increases and bonuses. Then came the ill-timed price reform that touched off an unprecedented inflation. The conservatives thus gained upper hand in the power struggle and put an end to the first-wave reform. In short, the major issue that touched off retrenchment in Hungary in 1972 was increasing income dispersion, while the prime reason for the retrenchment in the PRC since 1988 was inflation. The experiences of the two countries show that there is a trade-off relation between controlling income dispersion and stablizing consumer prices in a socialist market economy: a successful control of inflation by suppressing wages directly led to the deterioration of manual labor's income position. The regime could postpone ownership reform, and put aside the bankruptcy issue. It could further control the degree of income dispersion or inflation, but not both. In the end, it was the contradictions between economic and social values that forced the regime into a dilemma and put an end to its first drive toward industrial reform.

Hungary: wage control cum stratification

The Hungarian reformers introduced the NEM in a unique manner. In 1957, a number of economic committees, made up of both party and nonparty specialists, proposed the adoption of indirect methods of economic guidance. These proposals were first published, then rejected, and finally rediscussed and implemented after Kadar ousted his dogmatic opponents: Karoly Kiss, Imre Dogei, Gyorgy Marosan, etc. The Central Committee decided in December 1964 to initiate full discussions of the decentralizing reform, but no significant changes were made until January 1968 (Portes 1970). The reformers tried to construct a complete and coherent model, and introduced the reform en bloc in 1968, having taken only limited transitional measures in 1966–67⑲. The long gestation period and the en bloc, coherent introduction of the NEM enabled the reformers to carefully think through the possible side effects and to add to the reform package preventive measures. As it turned out, the regime created relatively favorable macroeconomic conditions for decentralized decision making.

Wage control was the technical secret of Hungary's success (Wiles 1974). From the very beginning, the reformers were aware of the des-

⑲ Between 1959 and 1965, several piecemeal measures were introduced that included the creation of a four-tier pricing system, a shift of power from the ministries to the trusts, a reordering of industrial priorities, the adoption of quality norms and the introduction of a new profit-sharing system. They were policy changes and were not comparable to the structural reform of 1968.

tabilizing effect of inflation once the pricing system was liberated. They then put into the reform package a tight wage control that linked managerial income with the sharing fund which would be reduced if there was an increase in average wage (Portes 1970)[20]. The average wage control directly pit the managers against the workers, since their incomes were inversely related. As such, it aroused great resentment and was modified at the end of 1969. However, the new formula (there were numerous versions of it since 1970) still linked specific aspects of wage (wages paid to newly hired workers, total wage bills, levels of individual employee earnings, wage increases above the increases in value-added, etc.) with managerial rewards through different ways (direct deduction of wage increases form the sharing fund, levies on the sharing fund, wage taxes, progressive taxation on individual

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[20] The NEM created a complicated incentive system. From gross revenues were deducted costs, which included materials, wages, depreciation, payroll tax, capital charge (in 1968 paid only assets owned by the enterprise; i.e., not financed by credit), and interest on short-and long-term credit. The enterprise then paid a further tax on gross revenues or received subsidies. The resulting amount was taxable profit. This was divided into development and sharing portions in proportion to the capital-labor ratio of the enterprise. The former was taxed at 60 percent, the latter progressively, leaving the development and sharing funds. A small part of each goes into a reserve fund. The enterprise could use the reminder of the development fund (plus 60 percent of depreciation allowances, on average) to expand fixed and working capital, while the sharing fund financed welfare expenditures and cash distributions to workers and staff. The rules governig these distributions made them a very substantial part of the incomes of executives (including the director and his deputies) and higher-level technical employees, but a much smaller part of manual workers' incomes, since wages were taken off revenues as costs before the sharing fund was created. The average wage control system deducted wage increases above the 1967 level from the sharing fund, thus forced managers to keep low the average wage level and seek cheap labor: a measure to combat cost inflation and unemployment, since the managerial rewards were tied with the sharing fund (Portes 1970).

earnings, etc.)[21] Some form of wage control was always in place, forcing the managers to restrict wage increases that they were inclined to make under soft budget constraints.

The Hungarian wage control served the dual purpose of checking both cost and demand inflation. With labor cost under tight control, the enterprises were not forced to raise product prices. The limits on wage increases also stablized the level of consumption. Even though the regime had difficulty in controlling investment hunger under soft budget constraints (witnesss the unexpected investment boom of 1970–71), the control over consumption still brough about a manageable aggregate demand. With both cost and demand inflation suppressed, the average inflation rate between 1967 and 1973 was only 1.6 percent (Kornai 1986a, 1770)[22].

Consumer price stability brought about by harsh wage control had its costs. Low productivity and income dispersion were the two major problem. The widespread practice by the managers to hire a large

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[21] In 1970, wages paid to newly hired workers were deducted from the sharing fund. In 1971, the sharing fund was cut back by increased taxes on profits and a new levy on wage increases. In 1976, a 35 percent wage tax and a highly progressive tax on the sharing fund were imposed to prevent rapid increases in personal incomes. Also in 1976, four forms of wage were institutionalized: relative wage level control, relative wage bill control, central wage level control, and central wage bill control. In 1985, there was progressive taxation on the levels of individual employee earnings rather than on the increases in average earnings, allowing enterprises to decide on earnings levels and increases on a worker by worker basis, without worrying about the effects of these choices on the overall increase in earnings, and only if the overall increase exceeded the increase in value-added would another tax be paid in addition to the taxes that were based on earnings (Buky 1972, 35; Hewett 1980, 511; Marrese 1981, 68-69).

[22] The increase in inflation rate following the first-wave industrial reform mainly had to do with the regime's attempt to use price increases to suppress domestic consumption for the purpose of austerity. It did not suggest the ineffectiiveness of the wage control mechanism.

number of unskilled, low-paid workers so that the base wages of more established employees could be increased while the wage level was kept under control resulted in low labor productivity㉓. This problem, however, could be solved by shifting enterprises from wage-level regulation to wage-bill regulation under which any decrease in staff translated into a greater opportunity for higher wages for the remaining workers. The new regulation system gave the enterprises strong incentives for rational utilization of labor without undermining the basic goals of wage control and the suppression of inflation.

The other major problem associated with tight wage control was income dispersion. The income group that bore the brunt of wage control was manual labor. They saw their income position deteriorating when compared with other classes in the society. Between 1967 and 1972, workers lost slightly to all social strata except pensioners. Real wages showed sharp deceleration in 1971–72 (Portes 1977, 786). For them life seemed to have been better under the old system, because then there were no striking differences in income within the populace, and now they became the have-nots (Volgyes 1976). They were against the new "middle class": the managers, shopkeepers, scientists, medical doctors, plumbers, and more than 30 percent of the active and working peasantry who belonged to the group earning more than 10,000 forints per month per household.

This problem was exacerbated by the reformers' deliberate actions to differentiate incomes across enterprises and industries. The architects of the NEM, Rezso Nyers in particular, believed that there was a conflict between efficiency and equality, that an increase in equality was associated with no increase in productivity, and that the material incentive system could stimulate work effort and productivity only if it was used for differentiation purposes on quite a large scale

㉓The annual growth rate of labor productivity in industry immediately after the introduction of the NEM was 0.9 percent for 1968, and 0.3 percent for 1969, compared with the average growth rate of 4.6 percent for the prereform years 1960–67 (Marrese 1981).

(Flakierski 1979, 17). These propositions then translated into a distributional policy strongly favoring the managers and workers in more profitable, not necessarily more productive,enterprises and industries.

The workers' frustration toward income differentiaion on the interenterprise, interindustrial, and intersectoral levels found an outlet in the newly liberated trade unions. In 1967, when the regime decided to legitimate interest group activities, it enacted a new Labor Code that granted trade unions the right of consent, the right of decision, the right of control, the right of veto, and the right of opinion. Since then the union had evolved into the strongest interest group in Hungary. Although still not comparable to its Western counterpart, the Hungarian union stood in stark contrast to the utilitarian and subservient role played by other East European unionss, with the exception of Yugoslavia. Under the NEM, the union gradually traonsformed itself from a transmission belt to a genuine representative of the workers' interest. The National Trade Union Council took an active role in the decision-making process and often came up with criticisms of the Party's policies concerning labor (Robinson 1973, 329). The union leaders insisted on wage equalization and limits on distribution of income according to skill or ability, on general wage increases, and on reaping the benefits enjoyed by the new "middle class" for the dispossessed. At the Party's Tenth Congress in 1970, the 22nd Trade Union Congress in 1971, and the Central Committee Plenum in 1972, the union leaders exerted great pressure on the regime to change its wage policy. This "workers' opposition" also found support in the Soviet Union and other socialist countries against the NEM and its antiegalitarian tendencies (Gati 1974, 30). The leveling impule in the ideology of Marxism-Leninism, the long years of repetitious propaganda slogans about the workers' favored position and "leading role," the obvious fact that it was the regime, and not some impersonal forces, that determined the wage levels, and the correct understanding that the flawed markets and enterprise-specific treatments were not just distributors of rewards further contributed to the resentment of the working class. High tensions between the state and the labor were created that could not be released through minor compromises as promised by the reformers (Robinson 1973, 332).

The first-wave reform in Hungary faced the greatest difficulty in the workers' opposition, though other factors also contributed to its reversal in 1972. In order to assure the bureaucrats and managers that the reform would not undermine their interests, the institutional hierarchy remained essentially unchanged under the NEM. The individualism and materialism encouraged by the reform were deplored by the conservatives in the Party. The enterprises and ministries were reluctant and ill-prepared to accept the risks of decentralized decision-making. The Soviet criticisms encouraged the conservatives to launch an anti-reform campaign. The 1970–71 investment boom and the following measures of austerity hampered the reformers' effort to release the brakes. Finally, the oil crises and the world recession created unfavorable conditions for liberalizing reforms. This being said, the fundamental issue determining policy changes since November 1972 was income distribution and the discontents of the urban, blue-collar working class. The reform simply left out the proletariat (Portes 1977, 784).

At the November 1972 Plenum Kadar sided with the "workers' opposition." He stressed the relative drop in the position of industrial workers, argued that equality had to take precedence over efficiency, and criticized petit-bourgeois excesses. As a result, the Plenum decided to increase wages for manual workers in state industry by 8 percent, ordered ministries to look into problems of the 50 largest industrial enterprises which resulted in restructuring of six of them by direct central intervention, and increased the powers of the planning and price control bodies. By 1973, central allocation planning was restored to 50 percent of the country's larger industrial enterprises (Gati 1974, 30). The price control regulations were tightened and a new inter-ministerial State Planning Committee was set up with the Natiional Planning Office acting as its working arm. In 1976 this committee had became the administrative vehicle for the reintroduction of dirrect administrative control in input allocation and import and export quotas.

An anti-private business campaign was launched in 1975, directed against auxiliary activities of the cooperatives and the second economy in general (Bauer 1983, 314)㉔. A system shielding large industrial enterprises against the external economic shocks was established (Haberstroh 1978; Bognar 1984, 48). Retrenchment took its political toll, too. Nyers was removed from the Central Committee's Secretariat in March 1974, together with Gyorgy Aczel, the Party's leading advocate of cultural tolerance. Then in May 1975, Jeno Fock was replaced as Prime Minister, and in July 1975 Deputy Prime Minister Matyas Timar was removed from his position. As a result of these personnel changes, the three major architects of the NEM were no longer in positions of power. The first-wave Hungarian reform in industry thus ended with the system devolving back in the direction of the old administrative model and the reformers removed from power. The political costs of economic efficiency proved too high for the regime to bear, and the country moved into a period of extended retrenchment for the bulk of the 1970's.

The PRC: excess demand and inflation

The dominant strategy in the PRC's industrial reform was experimentalism, or trial and error. For example, both the household responsibility system and the small private businesses (*getihu*) were products of local initiatives and the regime's flexibility in adjusting to the new environments and taking advantage of the status quo to achieve its own economic goals (Tang 1988). The industrial reform launched in 1984 was characterized by the same approach, which means maximum flexibility and a lack of coherent planning, in stark contrast with the Hungarian NEM. Even though a PRC delegation visited Budapest in 1979 specifically to study reform procedures (Hare 1988, 60), and the 1984 "Decision on Reform of the Economic Structure" reflected a con-

㉔Since the Hungarian first-wave industrial reform hardly touched on the issue of privatization, the retrenchment in the 70' mainly took the from of *demarketization*.

sultative decision-making process with scholars and experts both inside and outside government involved in it (Harding 1987, 212), the lack of a coherent and comprehensive platform put the Chinese reformers in an unfavorable position compared with their Hungarian counterparts and made them unable to think through the possible side effects and take preventive measures.

The crux of the matter was a lack of demand control (both in investment and in wage). Any marketizing reform entails liberating the pricing system, and that in itself inevitably creates a onetime price hike, as the previously suppressed prices jump to reflect supply and demand, but not sustained price increases that constitute inflation. However, price reform can trigger inflation by activating the full potential of excess demand. It is thus imperative that the market reformers take preventive measures to control aggregate demand when the prices are set free. Though not immune from the investment cycle, the Hungarians did suppress inflation in consumer prices by tightening wage control, and by using state subsidies to prevent the inflationary pressure in industry from spilling over to the consumer goods markets. Their Chinese counterparts, however, failed to institute any effective regulation of either investment or wage.

In the PRC, as in Hungary, the excess demand was mainly created by the soft budget constraint. The industrial reform had turned the enterprises from output maximizers to profit maximizers, but they still enjoyed a secure position even when making losses. Being immune from bankruptcy and buttressed by government subsidies, these enterprises tended to play down cost considerations and jump into risky investments and extravagant use of wage increases and bonuses to stimulate production. In the PRC, the contracts between the center and the provinces that set up the financial responsibility system (*caizheng baogan*)㉕gave a strong incentive to the provincial governments to ex-

㉕Under *caizheng baogan* the provinces are responsible for collecting a tax quota to be delivered to the center, while enjoying free disposition of the above-quota tax revenues. This system not only fueled inflation by encouraging provincial pand the enterprises within their jurisdictions. Furthermore, growth in production was still used as a major criterion to evaluate the performance of the local leaders (Li 1989, 659). These factors, together with the innate drive by the managers and their bureaucratic supervisors to seek expansion for prestige and influence purposes fueled the enterprises' insatiable demand for inputs. With the abolition of the central allocation system, the state enterprises could directly purchase factors of production from the market㉖. Since there was no effective wage or investment control, the demand on the factor markets rose sharply after the reform.

The most politically sensitive issue, however, was not producer prices on the factor markets, but consumer prices on the product markets. Neither the PRC nor Hungary was capable of fully controlling its producer prices, thought the Hungarians did not have to worry about rise in labor cost. It was the lack of effective wage regulation in the PRC㉗and its impacts on the consumer prices that made a great

governments to prompt the enterprises within their jurisdictions to expand, it also made the provinces financially more independent and exacerbated regionalism. At the Fifth Plenum of the Thirteenth CC in November 1989, the central planners tried to replace *caizheng baogan* with a new "tax sharing" system that would strengthen Beijing's financial control over the provinces. This plan was strongly opposed by the provinces and was not put into effeect.

㉖The share of the extra-budget investment by the state enterprises in their total investment had been increasing since the 60's. The reform accelerated this trend. Also, there was investment made by non-state sector, especially by the rural industry, that totally escaped state budgetary control (Perkins 1988, 617).

㉗A bonus system was introduced after 1978 to replace the egalitarian practice of "eating from the same big pot": providing practically equal wages to every worker regardless of productivity. However, bonuses were often provided indiscriminately to all workers, even in the absence of profits, thereby contributing to general wage increases. In May 1984 the government imposed a special tax on enterprises for excess bonuses (30 percent on bonuses equal to 2.5 to 4 months' wages; 100 percent on bonuses between 4 and 6 months' wages; and 300 difference between the two countries. A rapidly expanding wage bill in China directly raised the level of demand on the consumer product markets through the workers' marginal propensity to consume. Rising wage levels also contributed to cost increases b raising the price of labor. Being unable to control this critical aspect of the economy while pursuing a market reform, the Chinese reformers conjured up the specter of both demand-pull and cost-push inflation on the consumer product markets.

The loose wage control can be attributed to the regime's unwillingness to suppress the workers' income when the reform significantly improved the living standards of the peasants, the *getihu*, and those involved in the emerging private businesses, and later on, when inflationary pressures built up in the economy. The real wage reached its lowest point since the mid 60's in 1976, around 10 percent below the 1965 level, after declining steadily through the Cultural Revolution decade. After 1977, the real wage increased rapidly through 1980, by an amazing 20.9 percent. From 1980 through 1983, real wages stagnated and increased by only 1 percent (Naughton 1986). However, the same period witnessed the installation of the household responsibility system, the rapid increases in peasant income, the emergence of the ten thousand yuan households, and the proliferation of the prosperous *getihu* in the cities. In terms of sectoral income inequality between agriculture and industry, the traditional "urban bias" was substantially reduced during this period when the benefits of the economic reforms fell mainly in the rural areas (Adelman and Sunding 1987). But the urban residents complained heavily about the deterioration of their income position, and that only peasants and those involved in the private economy were benefiting from the reforms. This constituted one of

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percent above this limit). Also, the government announced a tax on increments in wages and bonuses from their 1984 level. As a result, enterprises began to raise base wages to escape the bonus tax and to establish a high base for 1984. The total wage bill of enterprises rose by 21.3 percent in 1984, 22 percent in 1985, compared with 6 percent in 1983 (Balassa 1987, 422; Li 1989, 657).

the major reasons for the introduction of the industrial reform in 1984.

Instead of tightening wage control to stave off inflation, as in the Hungarian NEM, the Chinese reformers made substantial upward wage adjustments at the end of 1984 before they raised consumption goods prices early next year. The idea was to reduce the shock of the price reform by compensating the workers beforehand (Naughton 1986). This policy made political sense when put into the context of wage stagnations of the previous three years, but the result was huge excess demand for consumer goods and a disastrous inflation that could only be brought down by curbing wage increases. This pattern was repeated in the following cycles. When the economy expanded, the wage bill swore, and then was slashed when the regime's policy shifted to contraction. It was obvious that the regime put great emphasis on the goal of maintaining labor's income position, even at the risk of incurring inflation㉘.

㉘Even though the income position of the Chinese manual labor relative to other social strata did not constitute the primary reason for the reversal of the reform, as in the case of Hungary in the rarely 70's, inequality brought about by the economic reforms did create social tensions in two areas: the income differentiation between eastern and western provinces, and the relative deprivation of the administrative employees and intellectual workers. The coastal provinces of China had been much more developed areas than the inland historically, a trend artificially suppressed by Mao's egalitarian policies and economic autarky. Shanghai was a typical case in its pre-1949 position as the country's largest and the most developed metropolitan area, and its diametrically opposite role as the base for the ultraleftist radicals during the Cultural Revolution period with stagnation of its development. The open-door policies in the late 70's and the golden coast strategy in the late 80's dramatically changed this situation and widened the east-west gap by granting more autonomy to the coastal provinces that enjoyed proximity to the world market, superiority in infrastructure, higher levels of education, and linkages with overseas Chinese. Under the policy of "permitting a part of the people to become prosperous before the rest," two Chinas emerged. The eleven western provinces and territories, with 300 million of

The state was ill-prepared for this inflationary situation. As the reform transferred more and more income power to the provinces and enterprises, the center could command less and less financial resources. The overextended investment, the rapidly expanding wage bill, and the huge government subsidies then directly translated into the state's budget deficits. Since the central bank, the People's Bank of China (PBC), was directly controlled by the State Council, there could be no independent monetary policy. The Ministry of Finance simply covered its budge deficits through overdrafts on its account with the PBC without any restriction (Li 1989, 657). As a result, the growth rate of money supply was determined by government spending. As the state enterprises spent more, more money was created. On the local level, the branches of the PBC were under the pressure of the provincial leaders to extend easy credits to the enterprises within their

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the country's 1.1 billion people, produced only 17 percent of the 1987 GNP of $293 billion. The ten provinces and municipalities in the east, with 360 million people, accounted for a remarkable 53 percent. In order to redress this interregional imbalannce, the central planners attempted to shift the industrial policy that favored particular regions to one favoring specific industries during the Eighth Five-Year Plan perion (1991–95). Another prominent income disparity was between the urban residents with fixed incomes and those actively involvhed in economic activities. The state's policy favored production workers with loose wage control and large bonuses, in sharp contrast with administrative employees and intellectual workers, who received no bonuses to offset price increases and saw their income position deterioratiog not only against rich peasants, private entrepreneurs, but also production workers (Naughton 1986). In 1978, state workers in knowledge-intensive occupations earned on average 2 percent more than manual workers; by 1986, manual workers earned on average 10 percent more than brain workers (Prybyla 1989, 6). However, this economically underprivileged group, particularly those of them in academic positions, enjoyed a relaxed intellectual climate in which they could easily find outlets for their dissatisfaction. The student demonstrations in both 1986–87 and 1989 were directly related with this economic background.

jurisdictions. The inability of the government on both the central and local levels to implement a tight monetary policy thus added to the inflationary pressure in the economy.

Excess demand on both factor and product markets, inflationary monetary policy, and structural distortions such as monopolized markets and two-tier pricing system[29]created a hotbed for inflation. When prices were decontrolled, the inflation rate surged. Then the state suppressed aggregate demand, and the economy slowed down. Unable to stand the drop of the single most important success indicator of the reform, the regime relaxed its contractionary policy, and another cycle began, only on a large scale. In 1984 with the beginning of the marketizing reform the state pumped into the economy 26.2 billion rmb, more than the total money supply of the past 30 years. The state then took contractionary policies in 1985 which plunged the industrial production into a record low. The economy was expanded again in 1986, only to be slashed by the "two tight policies" (tightening money and credit) in the autumn of 1987 when inflation was in the offing. As industrial production began to slide down in the first quarter of 1988, the reformers reversed their policy again. In May, an ill-timed price reform was implemented, touching off an unprecedented inflation. The regime was forced to adopt the harshest austerity policy, which gradually devolved into a major retreat of the reform. From 1984 to 1988, the first-wave industrial reform witnessed three cycles of expansion and contraction (*Jingji Ribao*, 3 November 1989), ending with an inflation rate of 18.5 percent in 1988. In sharp contrast with Hungary, where the first-wave industrial reform (1968—1972) was accompanied by only one unexpected investment boom in 1970—71 and with the consumer prices always under tight control, the PRC clearly failed to provide a stable macroeconomic environment for the reform (see table 1).

The mode in which the PRC's industrial reform shifted to retrenchment was similar to what happened in Hungary. First the paramount leader (Kadar in Hungary and Deng in the PRC) sided with the

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[29]For details, see Yu-Shan Wu,. 1990.

TABLE 1
Comparison of Inflation
Rate of Increase of Annual Consumer Price Index (%)

	Hungary		*PRC*
1968	0.0	1984	2.7
1969	11.4	1985	8.8
1970	1.3	1986	6.0
1971	2.0	1987	7.3
1972	2.9	1988	18.5
Average	1.5		8.6

Sources: Hare 1977, 321; Li 1989, 685.

conservatives at a critical central committee plenum to halt the reform and directed national attention to the neglected aspects: increasing manual workers' wages in Hungary and suppressing inflation in the PRC. Demarketizing and deprivatizing measures followed. There were institutional changes accompanying these measures, for example, the installation of the State Planning Committee in Hungary and the dismantling of the Research Institute on Reform of China's Economic Structure in the PRC, the former for reconcentrating planning power, the latter for destroying the reformers' most prominent think tank. Political toll was taken: Rezso Nyers, Jeno Fock, Gyorgy Aczel, Matyas Timar, etc. in Hungary; Zhao Ziyang, Hu Qili, Yan Mingfu, etc. in the PRC, though the political upheaval in Tiananmen Square hastened the downfall of the Chinese reformers. The country moved into an extended period of retrenchment, from 1972 to 1979 in Hungary; from 1988 to at least 1991 in the PRC (*People' Daily*, 17 January 1990). As history shows, the Hungarian reformers were able to put the country back on the reform track in 1979. The question is: what are the prospects for the PRC to follow suit in this direction?

The Second-Wave Reform

Hungary was foced back to the reform course by its insatiable demand for investment goods, deteriorating terms of trade in the 1970's (about 20 percent), world recession and the lack of competitiveness of its exports, trade imbalances, huge foreign debts, a 10 percent fall in national income, and finally requirements of austerity (Hare 1988; Kovrig 1987; Goldman 1987). At the end of 1978 and the beginning of 1979, Hungary's economic policy-makers recognized the gravity of the their problems and the dangers inherent in further delay (Bognar 1984, 46). To be sure, there was no necessary linkage between austerity and reform. In fact, the instincts of the regime were to strengthen central control over foreign trade, and domestic prices and material allocation to redress macroimbalances. It was the failure of the reconcentrating strategy and the availability of an alternative platform that changed the course of the country. In this sense, foreign debt/austerity was the catalyst for the second-wave industrial reform in Hungary.

The Hungarian reformers understood that at the root of the problem was the extension of the soft budget constraint to Hungary's trade with other countries. Because of the virtually absolute security enjoyed by Hungarian enterprises, they had neither the necessity nor incentive to economize on imports or search out profitable export opportunities (Hewett 1980, 184). Investment hunger ensued. Even though the government was successful in controlling consumption through wage policy and price policy, their control over investment was only sporadically effective. As a result, the average annual growth rate of investment increased from 7.0 peercent for the 1967-73 period to 7.8 percent for 1973–78, when the world economy was in stagnation after the oil shock (Kornai 1986a 1721). The ratio of investment over GDP also continued to grow, uninterrupted by the external situation. During the 70's, there were three investment booms: 1970–71, 1974–75, and 1977–78. It was in 1978 when national income utilized grew by 8 percent while national income grew by 3.9 percent, and dollar deficit rose to over a billion, that the central planners were forced to change their strategy. The immediate goal was to reduce the foreign trade deficit. The long-term objective was to improve the efficiency of the economy. A whole series of reform policies followed, with their emphases gradually shifting from austerity to marketization, and ultimately to privatization. These policies were always prompted and overshadowed by the persistent debt crisis. In 1979, austerity was introduced, and investment and consumption were cut. In 1980, a price reform was adopted in which the government used administrative methods to link domestic prices with world market prices through complicated simulation. In 1981, a single Ministry of Industry was created to replace the branch ministries in order to reduce bureaucratic interference in enterprises. In 1982, large state enterprises, ministries, and local councils were allowed to found new small firms in an attempt to deconcentrate the industrial structure. At the same time, in a major move toward ownership reform, many private activities in the second economy were legalized. In 1985, the state enterprises underwent a major transformation as councils and assemblies were created to assume control of the enterprises, a further move toward curtailing bureaucratic intervention and a transitional step toward creating joint-stock companies. A stock market was created, and 100 percent foreign ownerships were allowed. The dramatic political changes since 1986 and the democracy tide sweeping Eastern Europe in 1989 pushed the reform even further. Most of the policies of this second-wave reform, especially the early ones, were aimed at removing the defects of the old NEM, such as lingering bureaucratic control, monopolized market, and neglect of the second economy. The reformers were responding to their experience with the early reform and trying to perfect market socialism. But as the debt crisis persisted and deepened, the reform platform was grandually radicalized. Hence the increasing emphasis on privatization.

However, there is a basic contradiction between Hungary's obligation to service its debts and its need to recrnstruct the economy. Austerity requires reduced imports and forced exports, which means, among other things, a lack of market competition in import sectors and soft budget constraint for export sectors[30]. Hungary's heavy debt burden has been both a catalyst of reform and a big obstacle to it. It has forced recalcitrant politicians to take bold steps toward reassigning property rights. At the same time, it put serious constraints on what they can do to reconstruct the economy without bankrupting it with a liquidity crisis (Young 1989). The country is in a dilemma.

Forced reform under austerity is a highly probable scenario for the PRC in the 1990s. The country has accumulated a foreign debt of more than $40 billion. The debt-servicing peak will come in 1992. The Tiananmen incident has cost the regime considerable loans from the World Bank, IMF, and Japan, together with a slowing down of the flow of commercial credits that follow the lead of international financial institutions and major creditor countries. The country's export ability is seriously damaged as foreign businessmen must think twice before they invest new money in the export-oriented zones, cities, and areas of China, as the dollar-earning coastal provinces plunged into recession under the full sway of austerity, and as many of the most productive rural industries and private businesses were forced to close down by a squeeze of credits and materials, and a tax drive launched by the state. On the import side, without the actual implementation of the Bankruptcy Law, which will spread unemployment from the marrginal rural industries and private businesses to the backbone of the national economy--the state enterprises, there is no reason to expect any efficiency improvement, and every reason to continuation of the soft budget constraint, which means investment hunger and investment

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[30] Low import levels reduce competition on the domestic market and deprive developing companies of needed inputs, while the stress on exports makes officials reluctant to allow any firm that exports to the West to close, no matter how inefficient its production is. Many of these exporting companies are producers of raw materials and semi-finished goods that account for almost 50 percent of hard-currency earnings and are heavily subsidized by the state, which in turn not only taxes other companies more heavily, but also borrows from abroad to finance the budget deficit.

cycle will continue, together with their fatal impact on trade imbalances. The unwillingness and inability of the regime to tightly control the wage bill also suggests that the consumption level cannot be suppressed for long, and that the demand for imported consumer goods will rise again. Bearing the debt burden from the past, lacking the ability to expand exports, and unable to suppress the insatiable demand for investment and consumption goods from abroad, the PRC is heading toward a serious debt crisis and an ever increasing pressure for further austerity in the 1990s.

Even though currently austerity is leading the way to retrenchment in the PRC, as it did to Hungary during the 70's, it may very well force the countryy back to reform as the concentrating strategy proves ineffective in solving its financial problems. If this happens, the regime is likely to follow in Hungary's footsteps by launching a second-wave reform aimed at redressing macroimbalances in the short run and improving economic efficiency in the long run. In this scenario, measures will be taken to abolish the two-tier pricing system, delegate control power directly to the enterprises instead of the provinces, remove market monopolies and create a national market, minimize the use of economic levers (possibly by merging the branch ministries into a single ministry of industry), expel political cadres from the factories, and begin to enforce the Bankruptcy Law. The reformers will also tighten wage control when they make price reform, may be introduced as "one big earthquake" instead of " several small tremors." Like most of the reform measures in the Hungarian new NEM since the end of the 70's, the PRC's second-wave reform will be characterized by the regime's efforts to remove the perceived defects of the initial reform of 1984-88. The goal is to perfect "socialism with Chinese characteristics," or Chinese market socialism, and not to change the basic ownership structure of the economy. The emphasis will still be on marketization, not privatization. It is hoped that this time enterprises will have real power to make production and exchange decisions without interference from the cardres or bureaucrats, that the pricing system will genuinely reflect relative scarcities, and that firms will take full responsibility for their performances in the market, including accepting bankruptcies. None of these measures will run against the fundamentals of market socialism, which prescribes full play of market forces while maintaining public ownership. All the factors contributing to the original reform, such as the guiding philosophy of socialist enlingtened absolutism, the disillusioned population, the pragmatic leadership, the household responsibility system in agriculture, etc., plus the elite's unwillingness to privatize the economy for political or ideological reasons will militate for the deepening of the socialist market reform, once the requirements of austerity demand a change of the retrenchment policies. In thiis sense, the PRC will follow in Hungary's footsteps for yet another stage of development.

Conclusion

The developmental trajectories of Hungary and the PRC are remarkably similar. Even though one can find differences in their reform experiences in agriculture, in their attitudes toward marginal privatization, and in the issue that touched off retrenchment in the two countries, tthe overall pattern is the same. In both cases, there was a pragmatic leadership stiving to introduce maximum property rights reform without damaging their ultimate claim on the economy in an effort to raise the people's Iiving standards and to boost regime legitimacy in the eyes of a totally disillusioned population. The basic philosophy of socialist enlightened absolutism, the traumatic imprinting event, the victimized leadership, the great success in agriculture, and the thoroughness of the industrial reform that followed set Hungary and the PRC apart from other socialist countries. Both then evaded the thorny issue of job security, but failed to stave off the dilemma between competing material values of the society: efficiency vs. distributional equality in Hungary, efficiency vs. price stability in the PRC. Both were forced into retrenchment that is capable of stablizing the situation in the short run, but unable to improve efficiency of the economy. Finally, both countries are under the pressure of foreign debt, and the PRC may follow Hungary in adopting a second-wave reform as the only strategy that can successfully achieve the goals of austerity. In short, similar politico-economic institutions and a unique set of elite values and perceptions set the socialist market reform in motion, which developed into an unavoidable dilemma, a retrenchment, and pressures for a second reform, informed by the achievements and drawbacks of the first one.

This being said, the PRC may diverge from the Hungarian pattern even if the foreign debt/austerity scenario holds. A second reform following the principles of market socialism does not solve the financial problems that developed during retrenchment, as the Hungarian experience with the new NEM clearly shows. Even if all the perceived defects of the old reform formula were remedied, the system may still unable to improve its effciency enough to evade the liquidity crisis. With a more open attitude toward privatization than the Hungarians, and with capitalist enclaves already created along the coastal provinces, the Chinese reformers may well skip the stage of perfecting market socialism, and go directly to privatization. The scenario may begin with a full revival of Zhao Ziyàng's golden coast strategy, and the adoption of "new authoritarianism" as its accompanying political formula, meaning the elite have full power in pursuing efficiency-maximizing, exportexpanding policies regardless of ideological, bureaucratic, or popular opposition. Politcal authoritarianism, efficiency maximization, and export expansion immediately lead one to a new model: the capitalist developmental countries in East Asia. In this case, the negative referent of Hungary in the 80's and the positive referent of the NICs in the past four decades inform the regime of the best development strategy to pursue. The ROC's experience on Taiwan is particularly relevant here, not only because the CCP and the KMT have been competing for coming up with a better modernization formula for China, and thus observing each other closely for decades, but also because Taiwan shows how a state-dominated industry can be transformed into a private one through export expansion.

The other possibility is quite the opposite. Even though the PRC is more trade dependent than the U.S. with the share of foreign trade in its GDP at around 30 percent, it is a country much less vulnerable to trade imbalances and foreign debt than Hungary. This does not mean that the regime will move back to Maoist autarky under retrenchment. But it does suggest the debt/austerity fator may not be powerful enough to change the economic course of the country. Also the Kadar regime in Hungary was forced back to reform by an extremely adverse external environment composed of oil shocks, world recession, and finally international financial crisis. These do not have to happen to the PRC in the 1990s, which means the PRC's austerity program under retrenchment has a better chance to succeed than what was the case in Hungary in the 70's. In either case, debt/austerity not carrying enough weight or austerity working under retrenchment, the lack of a totally intolerable economic situation makes it unworthwhile for the regime to accept the serious political risks of any further reform. The system may naturally slide back to its old command mode. The tendency may be reinforced by the change in agriculture that has been in a deep grain crisis since 1985 and is able to regain the 1984 level of grain production in 1989 only at the expense of the control power granted to the peasants under the household responsibility system. If the grain crisis becomes so severe that the regime is willing to reimpose a collective structure on the peasants, the base of overall reform in the PRC will be undermined. The industrial structure may not slide back, but leap back, to the old command system.

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