

Reform without Losers:
An Interpretation of China's Dual-Track Approach to Transition*

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Abstract

This paper develops a simple model to analyze the “dual-track” approach to market liberalization as a mechanism for implementing efficient Pareto-improving economic reform, that is, reform achieving efficiency without creating losers. The approach, based on the continued enforcement of the existing plan while simultaneously liberalizing the market, can be understood as a method for making implicit lump sum transfers to compensate potential losers of the reform. The model highlights the critical roles of enforcement of the plan for achieving Pareto improvement and full liberalization of the market track for achieving efficiency. We examine how the dual-track approach has worked in product and labor market liberalization in China.