

# What the Change of System From Socialism to Capitalism Does and Does Not Mean

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**T**wo systems can be said to have dominated the 20th century: the capitalist system and the socialist system.<sup>1</sup> However, this judgement is not self-evident. It usually encounters three objections.

The first objection is that it is exaggerated and unjustified to mention the socialist system alongside the capitalist system, almost in parallel with it. In terms of world history, the socialist system was a brief interlude, a temporary aberration in the course of historical events.

That view could well be the one that historians take in 200 years, but it is not the way we who live in the 20th century see things. The establishment, existence and partial collapse of the socialist system have left a deep and terrible scar on this century. The socialist system persisted for quite a long time and still persists to a great extent in the world's most populous country, China. Its rule extended, at its height, over a third of the world's population. The Soviet Union was considered a superpower, possessed of fearful military might. The socialist system weighed not only on the hundreds of millions who were subject to it, but on the rest of the world's population as well.

The second objection questions whether there were only two systems. Is it not possible to talk of a third system that is neither capitalist nor socialist? I am not enquiring here into the question of whether it might be desirable to establish some kind of third system. I do not know what the 21st or 22nd century may bring. All

<sup>1</sup> I hold that the term "communist system" can be taken as a synonym for "socialist system."

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that can be said for sure is that the 20th century has not given rise to a distinctive third system.

The third objection delves further into the second, but from a different direction. Why do I speak of a single kind of "socialist system"? Certainly, the socialist system in the Soviet Union differed under Stalin and Khrushchev, both of which differed from János Kádár's Hungarian socialism or from the Polish socialism of Gomulka, Gierek and Jaruzelski.<sup>2</sup> Similarly, why do I speak of a single kind of capitalist system which includes the arrangements in today's United States and Sweden?

### **The Basic System-Specific Attributes**

These questions raise a fundamental problem of interpretation and classification. I suggest using "system" as a comprehensive and aggregate concept, and admit that each system exists in specific historical manifestations of various kinds. We are not facing an issue of choosing words arbitrarily; rather, the language (system versus historical manifestation) is based on generalization from observing history. The conceptual framework is admissible provided that the following three assertions can be confirmed.

1) The various historical manifestations of capitalism have common characteristics, so that they can legitimately be interpreted as variants of the same system. Similarly, the various historical manifestations of socialism have common characteristics, and therefore they can be regarded as variants of the same socialist system. Let us call these common characteristics the system-specific attributes of each system.

2) The system-specific attributes are sufficiently important to influence deeply the realities of society, politics, the economy, culture and daily life.

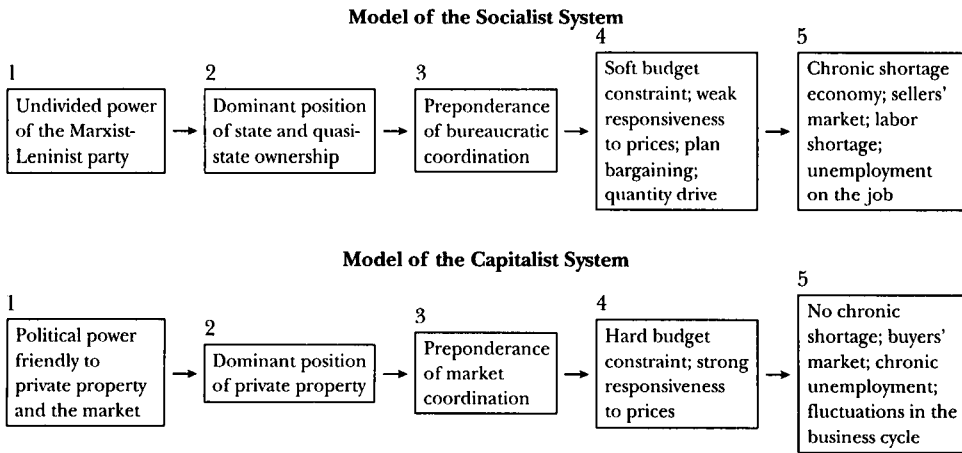
3) The system-specific attributes provide the essential criteria for distinguishing between the two great systems.

Figure 1 suggests a useful way of classifying the key characteristics of the capitalist and socialist systems.<sup>3</sup> I take a positive, and not a normative approach in trying to characterize both systems. What I term "socialism" is not an imaginary social organization that sincere believers in socialist ideas wish to apply. It is a historically established formation that existed in 26 countries and called itself the

<sup>2</sup> In a similar sense, Skidelsky (1996) distinguishes between the "mutation" of Soviet communism and the "species" of the "collectivist-communist system."

<sup>3</sup> Those familiar with my book *The Socialist System. The Political Economy of Communism* (1992) may recognize the upper part of Figure 1, which is taken from Chapter 15. The book attempts at some length to confirm that the features summed up tersely in the diagram really were the most decisive of socialism's various system-specific features. The description of capitalism has no comprehensive book to back it; however, the characterization of capitalism contained in the blocks of the diagram agrees with most literature on the operation of the capitalist system and with direct observations in daily life.

Figure 1  
**Model of the Socialist and Capitalist Systems**



socialist system; in our part of the world, we referred to it as “existing socialism.” Similarly, instead of summing up the characteristics deemed desirable by advocates of capitalism, the other part of the figure shows the main, observable traits of “existing capitalism.”

Clearly, I have not attempted a rich, flesh-and-blood description of either system, but a parsimonious, minimalist characterization, confining myself to the main characteristics that are necessary and sufficient for actual, historically observable systems to operate as socialism or capitalism. I focus on the basic system-specific attributes essential to distinguishing the two systems.

The first three blocks of the diagrams sum up the fundamental features of each system: what characterizes political power, the distribution of property rights, and the constellation of coordination mechanisms. Once these are in place, they largely determine the fourth block, the type of behavior typical of the economic actors, and the fifth block, the typical economic phenomena. The figure shows only a few of the behavioral regularities and lasting economic phenomena typical of each system; these lists could be continued.

A few comments on the diagram may prove useful. Many people may be surprised not to see the word “democracy” in block 1 of the capitalist diagram. I believe in the desirability of democracy, and I will return to the topic later, but the diagram is not intended to represent my political beliefs. As a positive statement, democracy is not a necessary condition for capitalism to function; it can operate under dictatorial regimes as well, as long as the political powers are friendly to private property, free enterprise and freedom of contract between individuals. The minimum required of the political sphere is not active support of private property and the market, but rather that authorities refrain from outright hostility. They must not carry out mass confiscation or undermine private property in other ways. They cannot introduce regulations that seriously, systematically and widely damage

the economic interests of the property-owning strata. They cannot lastingly banish market coordination from most of the economy. Rhetoric does not count for much here. (Hitler, for instance, railed against plutocracy.) The essential factor is the actual behavior in the political sphere.

The wording of block 2 concerning capitalism calls for dominance of private property. It need not rule absolutely. In modern capitalism, state-owned and nonprofit organizations can also play a role. It is enough to say that nonprivate organizations must not gain a dominant role.

Similarly, the wording of block 3 concerning capitalism calls for a preponderance of market coordination. Again, this does not rule out the presence of other coordination mechanisms, like bureaucratic intervention; however, an essential feature of capitalism is that the main mechanism of economic coordination occurs through the market, through mutual, decentralized adjustments of supply, demand, quantities and prices.

Blocks 4 and 5 of the diagram refer to regularities and lasting economic phenomena that are system-specific. The budget constraint on a state-owned enterprise under the socialist system is soft, whereas the budget constraint on a private firm under the capitalist system is hard. To take another example that does not feature in the figure, the large organizations in all economies show a propensity to expand, but only under the socialist system does this propensity turn into a ubiquitous, intensive, constantly recurring investment hunger.

Further, all economies experience departures from the idealized Walrasian equilibrium, but the chronic, general shortage economy is only characteristic of the socialist system, while chronic unemployment is characteristic of the capitalist system. These are system-specific economic phenomena that belong in block 5.

For the system to develop fully and the features described in blocks 4 and 5 also to appear in a consistent manner, it is not enough for typically "capitalist" or typically "socialist" attributes to appear in just one of the three blocks. There has to be a coincidence of "capitalist" or "socialist" characteristics in blocks 1–3. They have to appear together. That is the reason why countries like Austria (a large state-owned sector), or France and Sweden (a strong role for bureaucratic intervention and redistribution) remain only variants of the capitalist system.

### **Changing from Socialism to Capitalism**

The survey of the basic system-specific characteristics answers the frequent question of when the transition starts and when it is over. The process of transition begins when society shifts away from the fundamental characteristics of the socialist system described in blocks 1, 2 and 3, and finishes when society reaches the configuration of blocks 1, 2 and 3, characteristic of the capitalist system. Moreover, the new state of affairs has to strike roots and become irreversible.

The interpretation of transition and the criterion for determining the end of that period are not trivial issues and there is no consensus in this matter. For

instance, there is a widely accepted view that regards the transition as unfinished as long as the composition of output and real fixed assets is distorted and has not yet adjusted to demand, or the standard of living has not caught up with that in traditional market economies, and so on. The approach presented in this paper rejects the proposition that these otherwise important features of the economy are the criteria for accomplishing transition.

Countries changing from socialism to capitalism differ according to when the change begins, which block it begins in, and what reciprocal effects the changes have.<sup>4</sup> In discussing this change, it is important to distinguish between systemic and non-systemic change. Devaluation of the currency is not systemic; the introduction of currency convertibility is a systemic change in the amount of market coordination allowed. A reduction in the number of hospital beds, ordered from above, is not a systemic change; privatization of the family-doctor service is a systemic change in the boundary between state and private property. I distinguish between the two types of change by applying a simple test. I ask myself whether Erich Honecker would ever have introduced the change, as one of his reforms designed to “perfect” the socialist system in East Germany. If he might have done so, it is not a systemic change. Only systemic features can be entered in the blocks of the diagram. The distinction between systemic and nonsystemic change says nothing about the importance of the change. A non-systemic change may be extremely important, inescapable and pressing, while some systemic changes may be minor, and not of great import in themselves. Nonetheless, the distinction is vital, because it is a whole sequence of systemic changes that effects the change of system from socialism to capitalism.

The original transition to socialism did not arise by organic development: the socialist system does not originate spontaneously from the intrinsic, internal forces of the economy. Instead, the socialist system is imposed on society by the communist party with brutal force, when it gains power. It liquidates its political opponents and breaks up any opposition. The communist party that comes to power has a vision of what society, economy and culture it wishes to create: a system that eliminates private property and the market, replacing them with state ownership and planning. This vision has an ideological monopoly, so that any statement of sympathy with capitalism brings reprisals. When the “genetic program” of the socialist system has been implanted in the living organism of society, spontaneous forces begin to operate within it. The system completes itself and rejects the institutions and organizations incompatible with itself. It has followers, in no small numbers, who issue and execute the commands to realize the grand design.

What happens on the “return journey” from socialism to capitalism? Removing

<sup>4</sup> The article by Péter Gedeon (1997) provides an excellent review of the methodological questions affecting the literature on the change of system and the transition to a market economy. Among other things, his study helps to clarify for readers how the approach found in my works relates to the methodology of other authors and schools. The study by Murrell (1995) makes some thought-provoking comments on the subject.

the barriers to capitalism includes providing constitutional safeguards for private property, officially encouraging free enterprise, promoting privatization, legalizing advocacy of pro-capitalist ideologies, and so on. Capitalism does not need to be imposed on society; there is no need for a genetic program artificially implanted by a political party. If nothing else had happened but removal of the barriers, capitalism would still start to develop sooner or later, although the process would obviously have been much slower.

How should this expression "imposed on society" be understood? I realize there is no consensus in the social sciences about this. For example, Hayek (1960, 1989) argues that the capitalist economy evolves as a spontaneous order, while Polanyi (1944) underlines that the market is alien to human nature and has to be imposed on society by state means. I have the impression that both of these are extreme positions, which do not reflect adequately the complexity of the transformation. Careful analysis of the erosion of the socialist system, and after its collapse, of the evolution of the capitalist system provides a special opportunity to clarify the question.<sup>5</sup> In Hungary, which pioneered the reforms, there was no question of communist political power imposing private ownership on the economy in the period between 1968 and 1989. Nonetheless, private ownership began to develop spontaneously once the political sphere had become more tolerant. A similar process has been taking place on a vast scale in China. Further lessons can be drawn from the initial developments after 1990. Even in countries such as Czechoslovakia and Romania, where a strong communist dictatorship had applied up to the last minute, simply removing the administrative barriers was enough for vigorous development to begin in the private sector.

The strong difference between the two types of transition is apparent if the collectivization of Soviet agriculture under Stalin is compared with the Chinese agricultural reform in the Deng Xiaoping period. The former was imposed on the peasantry of the Soviet Union by brute force. The Chinese peasants, on the other hand, voluntarily began to farm the commune's lands individually; the authorities, through their regulations and measures, promoted this and helped to turn it into an initiative on a mass scale.

On the other hand, it has to be emphasized that the spontaneous development of capitalism speeds up significantly if the state is an active assistant. For capitalism to consolidate and operate efficiently, it is essential to have a legal infrastructure that protects private property and enforces private contracts and financial discipline. My purpose here is not to contribute to the debate on how big the state's part in the transition should be, only to the question of distinguishing the primary motive force behind the transformation and the method of change. Is the great change mainly directed from the top down, by brute force, or is it being actuated from the bottom up voluntarily? The essence of the distinction lies here.

<sup>5</sup> State coercion played an important part in the transition from pre-capitalist formations to capitalism in many countries. This is not discussed in this article, which concentrates on the transition from socialism to capitalism.

These arguments imply that while the interaction of political power, property and the modes of coordination are all important in movements between capitalism and socialism or back again, the political dimension plays the primary role. In terms of Figure 1, the transition from socialism to capitalism starts in some cases in blocks 2 and 3, but it can be completed only after the necessary change has occurred in block 1; namely, that the political sphere has become conducive to private property and market-friendly.

In terms of the political nature of the transition, three types of change from the socialist system to the capitalist system seem to emerge.

In type 1, the communist dictatorship is replaced by an anti-communist dictatorship. That happened in 1919, when the fall of Béla Kun's Hungarian Soviet Republic was followed by a period of White terror. Allende's rudimentary, immature, semi-complete socialist system in Chile fell to a military coup under Pinochet, who imposed a reign of terror for several years so that political power was democratized (not wholly consistently) only after capitalism had returned and consolidated. Similarly, the dictatorship imposed by the Soviet Union on Afghanistan gave way to an anti-communist, theocratic dictatorship.

Type 2 is exemplified by several of the eastern European countries which underwent a "velvet revolution." There was no phase of anti-communist terror. Instead, a democratic system rose out of the ruins of the old political regime. These countries have either developed the institutions of democracy, or taken appreciable steps towards doing so.<sup>6</sup>

China (and possibly Vietnam) may represent a transition of type 3. The communist party is transforming from within, through a change from a sharply, mercilessly anti-capitalist political force into one that is covertly, but ever more openly, pro-capitalist. There is interpenetration between the communist party at the central and especially local level and the leading stratum of private business. It is common for a party functionary to go into business while retaining office in the party. Or it occurs the other way around; the head of a state-owned company, or even the owner-manager of a private company becomes the secretary of the party organization. Where this merger of roles does not happen, a wife, brother, sister or child may do so instead, so that political and commercial power are literally kept in the family. This path could lead to a ruling party that continues to exercise political dictatorship, remains rhetorically communist, but in practice is no less friendly to private ownership and the market mechanism than Pinochet or the postwar South Korean dictators were. Another possible course is for the seeds of democracy to appear. There emerge opposition political groups hostile to the communist party, and the institutions of political democracy develop, steadily or by fits and starts. Other courses are also conceivable. I would not like to offer political prophesies.

With the help of the analytical framework expounded so far, I would like to

<sup>6</sup> Of course this cannot be said of all the countries of eastern Europe or all the republics that replaced the former Soviet Union. Important elements of dictatorial rule have remained, for instance, in the former Yugoslavia, in certain central Asian countries, in Belarus, and elsewhere.

take issue with one commonly advanced view. It is argued that there has not been a change of system at all, because there are still the same people on top, in the upper positions of society, as there were before. Some quote the old joke about the birds sitting in the tree. A gun is fired. They all rise in the air, and then land again. Each bird may be on a different branch, but the whole flock is back sitting in the tree. The joke has some evidence behind it. For example, in Hungary, a few years after the political turning point, well over half the economic elite had also belonged to the pre-1989 economic elite (Eyal, Szelényi and Townsley, 1998). Similar proportions have been found in Poland and Czechoslovakia (Böröcz and Róna-Tas, 1995; Hanley, Yershova and Anderson, 1995; Róna-Tas, 1994; Wasilewski, 1995).

The degree of turnover among the elite is an important problem, but a change in elites cannot be equated with the change of system. Even if the factory's present owner was once its communist party secretary, his present behavior will reflect a desire to earn profit and enhance the value of the firm, not to win the approval of district and county party secretaries. Part of the reason why new behavior patterns appear in block 4 is because the same people change their behavior: a member of the former economic elite acts differently after entering the new elite. Old friendships may gain the former cadre member a job for a time, but if he fails to meet the requirements, he will not have a successful second career and will probably be weeded out sooner or later. This process takes time. However, a market economy based on private ownership is able to select according to its own requirements and rules of the game with quite a high degree of certainty.

### **A Detour: Mixed Cases and Terminological Clarifications** /

So far I have contrasted the pure cases of the capitalist and the socialist system. History has also given rise to impure cases, to social formations in which components of the two pure cases are mixed to some extent.

Self-evidently, a mixed system is in place during the transition from capitalism to socialism, and in the transition from socialism to capitalism. But apart from the countries undergoing the great transformations, several other countries operated in mixed systems for a long time as well. India offers a prime example, with much more state-ownership and bureaucratic control than most other capitalist countries, and a ruling party with an ideology exhibiting some socialist features for two or three decades. However, the party did not include in its program the elimination of private property nor the market, nor did it seek the retention of power at all costs. Combinations similar in many respects can be found in certain periods of the history of other developing countries. It is too early to reach a final judgement, but the study of these episodes so far suggests that the mixed cases tend to return eventually to the path of capitalist development.

To avoid any misunderstanding, let me specify that I use the expression "mixed system" in a different sense than it is usually given in mainstream economics. In mainstream economics, "mixed system" applies to practically all modern capitalist



economies, since it refers to the state role in monetary and fiscal policy, and in certain welfare functions. According to the framework of the present paper, these are, using a musical term, variations on a theme. Various manifestations of the capitalist system may be democratic or dictatorial. They may differ in how open or closed they are in relations with the outside world. The state may play a range of different roles in the economy, including differing degrees of regulation, redistribution, and even direct provision of certain goods and services, like education, health care, and pensions. But as mentioned earlier, even if there might be a higher proportion of state ownership in Austria or a stronger role for bureaucratic coordination in France, or more redistribution in Sweden, that did not mean these countries had moved over to a socialist system, because the primary features in the fundamental blocks remained characteristic of the capitalist system. The differences between the various alternative manifestations are highly relevant. They are in the foreground of political struggles and competing ideas not only in the traditional market economies, but in today's transition economies as well. This statement notwithstanding, all these alternative arrangements are located within the choice set determined by the boundaries of the system-specific basic attributes of capitalism.

It is not possible, using the present conceptual system, to attach any useful interpretation to a statement by some political movement that it seeks a "social market economy" instead of capitalism. Take as an example the West German economy that developed after World War II, which many politicians are inclined to refer to as a "social market economy." According to the criteria applied in this study, West Germany simply had a variant of the capitalist system marked by a relatively active welfare state. I find nothing objectionable in qualifying the attribute "market" with the word "social," if the intention is to stress that an unfettered market generates a distribution of income that is found ethically unacceptable. But it is one thing to say that capitalism requires institutional correction, and another to give the impression that a "social market economy" and "capitalism" are two different social systems.

## **Two Certain Results from the Transition to Capitalism**

I have spent several decades comparing socialism and capitalism, and my conclusion is that two results follow inexorably, as a cast-iron rule, from the different system-specific features of capitalism and socialism—and only two results.

First, capitalism is a necessary condition of democracy. As with the interpretation of earlier concepts, I will avoid giving a normative definition. The starting point will not be what we "expect" of democracy; that is, what characteristics are possessed by a regime that merits the name of a democracy. Instead, I would like to offer a positive, descriptive and explanatory definition. It should be based on distilling out the common features from the countries that are widely agreed to be

democracies.<sup>7</sup> Democracy is a conjunction of the political organizations, institutions, social norms and confirmed forms of behavior that provides certain operating conditions for society. I list here four minimum conditions of a workable democracy; even the order of them is important.

1) The government can be dismissed, and the dismissal takes place in a civilized way. To us Eastern Europeans, it is quite clear what is meant by dismissing ruling figures or groups in an uncivilized way; they are murdered, become victims of a coup d'état, are executed or imprisoned after their dismissal, are removed by an uprising, and so on.

2) Democracies use an electoral procedure for civilized dismissal. The procedure is controlled by laws complemented by conventions. The electoral procedure reflects the political sympathies and antipathies of the public to some extent. I abstain from putting it more strongly by saying that democracy expresses "the will of the majority" or "the will of the people," since the transmission connecting the preferences of the citizens with the composition of the parliament and government by the electoral process is not free of frictions and distortions.<sup>8</sup>

3) In a democracy, no political power or political ideology has a monopoly secured by state force. The political process rests on competition: parties, movements and political groups vie with each other for votes and other political support. Consequently, every democracy operates as a multi-party system.

4) Democracy does not simply enact political freedoms, it guarantees them in practice. The state cannot forcibly obstruct freedom of expression, freedom of the press, or freedom of association.

To use a simple and easily verified criterion, democracy can be considered to have been consolidated to some extent once there have been free elections at least on two occasions, offering a realistic chance to dismiss the government from office. That criterion clearly classifies, for example, the current political regimes of the Czech Republic, Hungary and Poland as democracies.

There has been no country with a democratic political sphere, past or present, whose economy has not been dominated by private ownership and market coordination. However, private ownership and markets are not sufficient to produce democracy. As mentioned earlier, there were and still are several countries with

<sup>7</sup> There is no consensus in political theory on the interpretation of democracy. The views expressed in this paper are shared by many political theorists. Schumpeter's classic *Capitalism, Socialism and Democracy* (1947, ch. 21, and also p. 269) is seen particularly as the pioneer. According to Huntington's (1991, pp. 5–7) succinct description, this approach starts from "empirical, descriptive, institutional and procedural definitions," in contrast to other theories, which apply utopian, idealistic definitions of democracy. Such "empirical-descriptive" interpretations are also applied in the well-known works by Dahl (1971) and Lindblom (1977), although different authors do not classify the main features in exactly the same way, of course.

<sup>8</sup> As Samuel Huntington (1991, pp. 9–10) writes, "Elections, open, free, and fair . . . [may produce governments that are] inefficient, corrupt, shortsighted, irresponsible, dominated by special interests, and incapable of adopting policies demanded by the public good. These qualities may make such governments undesirable but they do not make them undemocratic."

non-democratic, autocratic, even thoroughly tyrannical political regimes, whose economies have been dominated by private ownership and market coordination. This combination is certainly viable in the short term, and even in the medium term.

In the longer term, will a market economy based on private ownership help to bring about the emergence of a democratic political regime? There are several historical examples in which the voices and interests of capitalist markets seem to have helped bring democratic transformation, including in southern Europe, and in several far eastern and Latin American dictatorships. However, when systematic econometric calculations have been made to analyze the relation between democracy, market-economic institutions and growth, using long time-scales for large numbers of countries, in the end the research based on a sample of historical data is still not entirely conclusive (for example, Barro, 1991, 1996a, b; Tavares and Wacziarg, 1996). The hypothesis is neither clearly confirmed nor wholly rejected. Further historical experience, including the recent and future history of post-socialist transition, will provide additional evidence on this point.

The value of democracy can be judged in two ways. One is to look at the instrumental value of democracy. It is sometimes argued that democracy promotes economic growth and material welfare. For example, Olson (1996, p. 18) argues that the smooth running of private ownership and the market mechanism benefits from the security and reliability of a constitutional state, as opposed to tyrannical rule, where the whims of a dictator make events harder to forecast. While this effect is plausible, it is not the entire story, as discussed by Offe (1991), for instance. Observing the rules of democracy may make it more difficult to introduce desirable policies. There exist highly efficient autocratic regimes, like Taiwan and South Korea in the early decades after the World War II, and Singapore today, and there exist sluggish democracies, like India in most of the post-World War II period. Investors can favor either the stability of a consolidated democracy or the stability of a dictatorship ruled with a firm hand, but they are repelled by severe instability, whether it occurs in a democratic or an authoritarian regime.

However, it is possible that the rapid flow of information in modern society is adding the possibility of a stronger connection between democracy and growth. In an age of computers, photocopiers, fax machines and the Internet, the prohibitions of dictatorships restrain the spread of inventions, innovations and business news, which curbs participation in the global business network. Sooner or later, the technical revolution induced by computers will pressure countries which have placed political constraints on communications either to lift their barriers to freedom of speech and freedom of association, and thus to encourage democracy, or to fall behind inexorably in the global economic competition.

I am convinced that the primary argument in favor of democracy must lie not in its instrumental but in its intrinsic value in guaranteeing political freedoms and preventing tyranny. According to my personal value system, this has great value.

Other people who judge by other sets of values may rate it differently.<sup>9</sup> Those who disparage democracy—because it was never important to them, or they have forgotten how it felt to live shorn of political freedoms, under a tyrannical government imposing its rule by force—can never be convinced of the extraordinary relevance of this virtue of capitalism. Even those who set great score by democracy need to realize that the plain fact of the change of system does not guarantee it. The shift to capitalism simply establishes one of the necessary conditions for democracy.

The second major advantage of the capitalist system is that technological development is faster, because the capitalist system is more inclined to pursue innovations. Capitalism and entrepreneurship clear the way for enterprise and initiative in the economy. It makes more effective use of human and physical resources than the socialist system. This means that measured over longer historical periods, it is faster at increasing production and labor productivity, and thereby the material welfare of human beings.

Let me refer here to an author seldom cited these days: Vladimir Ilyich Lenin. He announced, right at the start of the introduction of the socialist system, that the race between the capitalist and socialist systems would ultimately be decided by which could ensure higher productivity.<sup>10</sup> The real significance of the turning point in 1989–90 is that the socialist system lost the race. This is clearly confirmed by comparative statistics showing the two systems' economic results, taken over a long time-scale. As one example, Table 1 compares three socialist countries with four capitalist countries at a similar level of development in the base year of 1950. Not only did the GDP of the socialist countries grow more slowly than that of the capitalist countries, but as shown in the last column, workers in the socialist countries spend much longer at their place of work. In Table 2, Austria is compared with Czechoslovakia, Hungary and Poland. This comparison is historically justified, because until the end of World War I, Austria, Hungary, the territory that later became Czechoslovakia, and part of present-day Poland constituted the Austro-Hungarian Monarchy. Austria was always the most developed country in the group, but the lag by the other countries increased further under the socialist system. The result of the economic race between capitalism and socialism shows dramatically in the case of the divided countries: compare East and West Germany before reunification, or present-day North Korea, on the brink of famine, with prosperous South Korea.

This stronger performance proceeds from the basic characteristics of the two systems. The capitalist system's advantage in this respect infallibly applies, although

<sup>9</sup> This train of thought leads to an important warning against biased comparisons between Chinese success and post-Soviet failure. The judgement depends on the value-system of the evaluator: how much weight is given to the intrinsic value of breaking political tyranny.

<sup>10</sup> "Socialism calls for greater productivity of labor—compared with capitalism and on the basis achieved by capitalism," wrote Lenin (1918[1969], p. 248).

*Table 1*  
**Growth and Labor Input, 1950–1989**

	<i>GDP per Capita</i>		<i>1989/1950, in %</i>	<i>Annual No. of Hours Worked per Capita 1987</i>
	<i>In 1950</i>	<i>In 1989</i>		
Czechoslovakia	3,465	8,538	246.4	936
Hungary	2,481	6,722	270.9	839
Soviet Union	2,647	6,970	263.3	933
Greece	1,456	7,564	519.5	657
Ireland	2,600	8,285	318.7	524
Portugal	1,608	7,383	459.1	738
Spain	2,405	10,081	419.2	591

*Note:* The table shows the figures for the three European socialist countries that appear in the relevant tables to be found in the source. These are compared with those for the four European capitalist countries that were least developed in the base year (1950). GDP per capita, reported in the first and second columns, is measured in U.S. dollars at 1985 U.S. relative prices.

*Source:* Maddison (1994, pp. 22 and 43).

*Table 2*  
**Increase in the Lag behind Austria (percentages: Austria = 100)**

	<i>1937</i>	<i>1960</i>	<i>1970</i>	<i>1980</i>
Czechoslovakia	90	91	78	70
Hungary	63	56	51	52
Poland	53	54	47	45

*Note:* Although the table ends in 1980, it is clear from other sources that the lag behind Austria has continued to increase in recent years.

*Source:* Marer (1989, p. 73). The calculation is based on the “physical indicator” method, elaborated by Jánosy and Ehrlich. For the description of the method see Marer (1989, p. 44) and Ehrlich (1991).

different periods elapse in different countries before the advantage emerges. In some it takes years to emerge, and in other cases perhaps even decades.

### The Requirement of Clear Analysis

The two great advantages offered by the change of system require time to unfold, and may require great sacrifices as well. However, it is important to distinguish among four different causes of trouble and discontent that may arise in the transition from socialism to capitalism.

One possible cause of discontent is that a formerly socialist country’s level of

development has fallen far short of the most advanced countries. There are many historical causes of this backwardness and relative poverty, one of them being the low efficiency of the earlier socialist system. There is no rapid way of overcoming the problems deriving from backwardness. They can only be alleviated by lasting growth. However, it is important to remember that this feature did not primarily originate from the change from socialism to capitalism.

Second, some problems arise because the economy and the society is in a transitional state. These can be described in sentences that include the word "still." The new supply structure adjusted to demand has still not emerged. The expertise and experience for operating a market economy and a democratic political system are still lacking. The institutions of the new system have still not developed. These problems are temporary. There are grounds for confidence that the problems of transition can be overcome sooner or later, and that governmental measures can help this process.

A third set of problems arise because the capitalist system possesses some intrinsic, system-specific disadvantages. Just as the socialist system suffers from chronic shortage, so the capitalist system is normally accompanied by chronic unemployment. The wage levels from a labor market controlled by the market mechanism, coupled with the existence of capital incomes and the system of inheritance deriving from the right of free disposal over private property, generate inequality. One feature of the "buyers' market" of capitalism is excessive advertising, as sellers try to win buyers by every possible means.

It is not worth registering surprise at these occurrences, or at other detrimental features characteristic of capitalism. Instead, let the people of the post-socialist region decide whether the two big advantages mentioned, which follow from the introduction of the capitalist system, compensate for the intrinsic problems that also accompany it.<sup>11</sup> If they do not compensate, let them advocate a revolutionary rejection of capitalism. If they do compensate, let them advocate appropriate government policies to ease these problems and work to define the version of capitalism that they prefer.

Finally, there are the errors and misdeeds committed by governments, officials, politicians, employers and employees, and parties and organizations. Dishonesty, corruption, negligence and incompetence exist. We have to fight against them. I would certainly not like to see any abatement of the struggle against errors and misdeeds. Even so, there is no harm in considering with a measure of wisdom that errors and misdeeds are part of human existence, and are not the exclusive property of either capitalism or socialism.

I find it understandable that the citizens of post-socialist countries do not

<sup>11</sup> In Kornai (1980), I wrote ironically of those who look upon the range of systems in history as a supermarket. It is as if we could push a shopping cart around and pick full employment off the socialist shelf and technical development and an abundance of goods off the capitalist shelf. History, I wrote at the time, offers package deals with fixed contents, labeled as alternative systems. Each package contains the system-specific advantages and drawbacks of the formation chosen.

carefully analyze and distinguish the separate causes just mentioned, and simply feel angered or embittered by the problems. However, what is understandable in lay citizens becomes unacceptable in social scientific researchers, highly qualified intellectuals, opinion-makers, and above all, politicians. These distinct groups cannot be allowed to get away even with well-meaning superficiality and ignorance, let alone with intentionally confusing the various causes of the country's problems, which too easily feeds the forces of cheap demagoguery and populist agitation.

■ *This paper draws extensively on Kornai (1998). Because the limitations of space, it is much more compressed; for further details and more elaborated discussion, the reader is referred to that booklet. I gratefully acknowledge the energetic participation of the editors of this journal, and Timothy Taylor on the first place, in the painful process of compression and I wish to thank them for many inspiring remarks.*

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