

6-1-2010

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Richard D. Cudahy

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### Recommended Citation

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# FROM SOCIALISM TO CAPITALISM: A WINDING ROAD

Hon. Richard D. Cudahy\*

## Abstract

*Three great economic shifts have shaken the world in the last thirty or forty years. The Soviet Union, the torch-bearer of socialism, after engaging in an inner-generated perestroika (reconstruction), increasingly veered toward a stronger role for the market until it moved to full-blown capitalism. At about the same time, China, another beacon of socialism, also moved inexorably toward a socialist market economy and eventually to a virtually capitalist approach. But the Soviet Union, now fragmented, with the Russian Republic its remaining flagship, moved politically toward an imperfect democracy and suffered a painful economic decline. Meanwhile, China retained the authoritarian rule of the Communist Party in full control and its reaction to the change was surprisingly favorable with spectacular growth and remarkable prospects. And while these profound transitions rocked the socialist powers, the US, the capitalist titan, together with the whole capitalist world, suffered its own slide into sudden recession with severe hardship, unemployment and exploding fiscal deficits. This Article explores the ramifications and relationship involved in these various and contrasting developments.*

## Table of Contents

I. Introduction.....	40
II. Socialism in the Soviet Union .....	40
III. Leaving Socialism Behind.....	47
IV. Contemporary Events in China.....	52
V. Economic Decline in the United States .....	58
VI. Conclusion .....	64

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\* Senior Circuit Judge, US Court of Appeals for the Seventh Circuit; BS, US Military Academy; JD, Yale Law School. I appreciate the invaluable assistance of my law clerk, Alan Devlin, in preparing this Article for publication.

## I. INTRODUCTION

In recent years, there have been two cosmic collapses of contrasting economic systems: first, the socialist system involving the former Soviet Union and its Eastern European allies experienced a rather sudden decline and crisis and was transformed painfully into a part of the world capitalist system.<sup>1</sup> Later the world economy, predominantly capitalist in character and led by the US, entered an abrupt decline, which is still ongoing as I write.<sup>2</sup> Meanwhile, a third economic entity, China, nominally socialist, but trending toward capitalism, experienced part of the world-wide decline but displayed remarkable health and resilience and was thought by many to be moving to a leading position in the world.<sup>3</sup> All this may be telling us something about capitalism and socialism, their futures in the world, and, more generally, about the role of government in the dominant economies of the future. To explore these issues we will first examine the decline and fall of the Soviet Union and related systems. Then we will examine contemporary events in China, where some but not all the same forces and counterforces were at work but with strikingly different results. In contrast with these Soviet and Chinese experiences, we will explore the financial crisis and economic decline in the US and its consequences. Finally, we will attempt to determine what comparative analysis can tell us about policy trends and our policy choices in the years ahead.

## II. SOCIALISM IN THE SOVIET UNION

Until about 1975, the health of the Soviet planned economy was not in such serious question that anyone feared its collapse. Its growth rate since at least 1928 had been robust, even though experts might quarrel about its precise strength.<sup>4</sup> However, the economy had obvious areas of weakness. One such area was agriculture, where collectivization had apparently led to declining productivity and an inability to meet the needs of the country for food.<sup>5</sup> Further, the efficiency and productivity of the economy, in contrast to its maintenance of

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<sup>1</sup> See Prem Shankar Jha, *The Perilous Road to the Market: The Political Economy of Reform in Russia, India and China* 36–38 (Pluto 2002).

<sup>2</sup> Consider Richard A. Posner, *A Failure of Capitalism: The Crisis of '08 and the Descent into Depression* (Harvard 2009).

<sup>3</sup> See Jha, *The Perilous Road to the Market* at 89 (cited in note 1).

<sup>4</sup> See David Kotz and Fred Weir, *Revolution from Above: The Demise of the Soviet System* 36 (Routledge 1997).

<sup>5</sup> See Andrei A. Baev, *The Privatization of Land in Russia: Reforms and Impediments*, 17 Loyola LA Intl & Comp L Rev 1, 12–13 (1994).

gross levels of production, could be cast in doubt. Particularly in later years, there were obvious concerns about the environmental impact of economic activity.<sup>6</sup>

Another unarguable defect of the economy was its apparent inability to manufacture consumer goods (or even capital goods) of passable quality. According to one informed estimate and viewing matters most indulgently, only seventeen to eighteen percent of Soviet manufactures were of a quality corresponding to world standards and exportable to the West.<sup>7</sup> This was a serious deficiency because, among other things, it sharply limited the potential for hard currency export earnings based on the sale of manufactured goods. Significant exports were limited to natural resources—primarily oil and gas.<sup>8</sup> Russia and its associated lands were well endowed with resources, but resource prices were dictated by international forces and were beyond domestic control, or even significant influence, leaving the domestic economy at the mercy of international price trends. This was an important factor in Soviet and Russian economic trends in the 1980s and beyond.<sup>9</sup> On the other hand, if Russian manufacturing had been capable of meeting international standards there is every reason to believe that foreign trade could have been stabilized and the impact of world prices on the Soviet economy reduced. Another related problem in the Soviet economy was the persistent shortage of consumer goods in the domestic channels of distribution.<sup>10</sup> This problem was in part related to manufacturing inadequacies, but also to the failure of prices to reflect demand.<sup>11</sup>

In any event, before about 1975, growth rates were satisfactory and there was no general concern that the Soviet economy was headed for decline or collapse.<sup>12</sup> These circumstances were reflected not only in the thinking of the Soviet leadership but in Western, and specifically American, quarters as well.

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<sup>6</sup> See Douglas Lind, *The Crane, the Swamp, and the Melancholy: Nature and Nihilism in Soviet Environmental Literature and Law*, 23 Notre Dame J L Ethics & Pub Poly 381, 383–87 (2009).

<sup>7</sup> See Kotz and Weir, *Revolution from Above* at 41–42 (cited in note 4); Anders Åslund, *Gorbachev's Struggle for Economic Reform: The Soviet Reform Process, 1985–1988* 17 (Pinter 1989).

<sup>8</sup> See William G. Frenkel and Michael Y. Sukhman, *New Foreign Investment Regimes of Russia and Other Republics of the Former U.S.S.R.: A Legislative Analysis and Historical Perspective*, 16 BC Intl & Comp L Rev 321, 322–23 (1993).

<sup>9</sup> See Yegor Gaidar, *The Soviet Collapse: Grain and Oil*, (American Enterprise Institute for Public Policy Research, Apr 19, 2007), online at <http://www.aei.org/issue/25991> (visited Apr 30, 2010).

<sup>10</sup> See George L. Priest, *The Ambiguous Moral Foundations of the Underground Economy*, 103 Yale L J 2259, 2271 (1994).

<sup>11</sup> See Janos Kornai, *The Hungarian Reform Process: Visions, Hopes, and Reality*, in Victor Nee and David Stark, eds, *Remaking the Economic Institutions of Socialism: China and Eastern Europe* 41–42 (Stanford 1989).

<sup>12</sup> Consider Gertrude E. Schroeder, *Reflections on Economic Sovietology*, 11 Post-Soviet Affairs 197 (1995).

There was still great concern in the West that the Soviet Union might eventually succeed in overwhelming its rivals, and this attitude certainly did not suggest any general expectation that the Soviet economy was on the verge of collapse.<sup>13</sup> In addition, most observers in the West were still impressed with Soviet accomplishments in space and in other military and quasi-military spheres, where various achievements were quite notable in contrast to obvious deficiencies in the consumer area. Hindsight has led to a general belief that the Soviet economy collapsed of its own weight in 1990, but, despite its deficiencies, it is difficult to make a case for an obvious fatal decline extending many years into the past and giving clear warning of collapse.<sup>14</sup>

Why then did the Soviet socialist economy enter into a period of instability after about 1985 and eventually show signs of failure and collapse? How did these events relate to comparable events in China? And were these developments related in any way to the subsequent crisis in the US economy? What lessons are to be drawn from these respective collapses and what do they portend for future economic developments in the world?

The first development leading to the downhill Soviet slide after 1985 was a gradual decline in the Soviet economic growth rate after 1975.<sup>15</sup> Until about then, nothing seemed radically amiss except for the problem areas already noted. In 1985, Mikhail Gorbachev became General Secretary of the Communist Party of the Soviet Union; in effect, the leading figure of that country.<sup>16</sup> He, like others, was aware of the declining growth rate and of other indications that the economy and the country were in need of energizing. So he set out to reform the economy and the political system as well. This was to be done through *perestroika* (reconstruction) and *glasnost* (openness).<sup>17</sup> But Gorbachev's thinking did not include a withdrawal from socialism. In fact, he was a dedicated socialist and continued in that faith even when his country renounced it.<sup>18</sup>

Gorbachev's demands could be summarized by the slogan "acceleration of economic development."<sup>19</sup> He emphasized the need for qualitative

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<sup>13</sup> Id.

<sup>14</sup> See Kotz and Weir, *Revolution from Above* at 226–35 (cited in note 4).

<sup>15</sup> Consider Robert C. Allen, *The Rise and Decline of the Soviet Economy*, 34 Can J Econ 859 (2001).

<sup>16</sup> See Jonathan D. Greenberg, *The Kremlin's Eye: The 21st Century Prokuratura in the Russian Authoritarian Tradition*, 45 Stan J Int'l L 1, 10 (2009).

<sup>17</sup> See Veronika V. Kravchouk, *New Religious Movements and the Problem of Extremism in Modern Russia*, 2004 BYU L Rev 507, 510 (2004).

<sup>18</sup> See Alexander Yakovlev, *Russia: The Struggle for a Constitution*, 7 Emory Int'l L Rev 277, 283–84 (1993); Åslund, *Gorbachev's Struggle for Economic Reform* at 182–87 (cited in note 7); Kotz and Weir, *Revolution from Above* at 152 (cited in note 4).

<sup>19</sup> See Vladimir D. Shkolnikov, *Modernization and Russian Democracy*, 29 Fletcher Forum World Affairs 21, 21 (2005).

improvements: an increase in efficiency and quality, an acceleration of the scientific-technical program and better use of the existing potential. He thought that “[c]ompetition should be organised[sic] so that it was oriented not towards gross production but ‘even work rhythm, timely fulfillment of contract obligations, high product quality, introduction of new technology, prudent utilization of working time, raw materials and money.’”<sup>20</sup> He decried the lack of balance between supply and demand. He particularly emphasized improvements in agriculture, which had been his specialty, as a place for reform to begin.<sup>21</sup> Significantly, he favored changes in the political system, developing socialist democracy and openness of information, competition of ideas and self-management and self-government.

The relationship of the political to the economic has been a key problem for Soviet-style socialism since the beginning. Socialism, as prescribed by Marx, was primarily an economic doctrine. In the Soviet context, its political dimension, which as things developed became its most controversial, was supplied by Lenin. Democratic centralism, monopoly of power by the ruling party, the leading role played by the party, the arbitrary application of power, and the extraordinary disregard of human rights were all earmarks of this Soviet political system, inspired by Lenin.<sup>22</sup> Presumably, one of the prime motivations of Gorbachev, in his search for reform, was to change the political system to adopt many of the values of Western democracy, including the rule of law. Gorbachev was trained as a lawyer, and respect for the rule of law was a value that sprang naturally from his background.<sup>23</sup> He aspired to democratic socialism, socialism with a human face, and, not incidentally, a more efficient socialism.<sup>24</sup>

Of course, there are many in the West and elsewhere who aspire to a democratic socialism and who in fact ascribe the failures of socialism to the political path chosen by Lenin. These observers fervently believe that, with a firmly democratic polity, even classical socialism could succeed. Presumably, they would be of the view that Gorbachev was on the right path, and left to his own devices could have steered the Soviets back to a winning course of development. There are, of course, also those who take precisely the opposite

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<sup>20</sup> Åslund, *Gorbachev's Struggle for Economic Reform* at 27 (cited in note 7) (citing Mikhail S. Gorbachev, *Izbrannye rechi i stati*, Vol 2 at 91 (Politizdat, Moscow 1987)).

<sup>21</sup> See Jha, *The Perilous Road to the Market* at 27 (cited in note 1); Åslund, *Gorbachev's Struggle for Economic Reform* at 29 (cited in note 7).

<sup>22</sup> See Kotz and Weir, *Revolution from Above* at 18–20 (cited in note 4).

<sup>23</sup> See Jeffrey Kahn, *Vladimir Putin and the Rule of Law in Russia*, 36 Ga J Intl & Comp L 511, 515 (2008).

<sup>24</sup> See Carlton Herzog, Note, *Ramparts and Palisades: Archetypal Structures in Hostile Battles for Corporate Control*, 42 Rutgers L Rev 817, 828 n 65 (1990).

view, those orthodox Communists who believe that only a Leninist political structure can successfully manage a genuinely socialist society. Presumably, those folks are in charge in Cuba and China today. This is a debate that cannot be resolved within the limits of the present discussion. However, one must wonder whether the eventual failure of Gorbachev's pursuit of a democratic socialism did not demonstrate some of the eventual unrealism of his aspiration: whether in the end either socialism or democracy had to yield. In Russia, it was first socialism that gave way, and subsequently genuine democracy. Of course, there have been many regimes in the West that were at least nominally socialist without departing from democratic practice, but their socialism would not have been recognized as such by socialists of the Soviet stripe. In any event, the focused, inflexible and doctrinaire socialist faith of followers of Lenin is difficult to fuse with genuinely democratic practice.<sup>25</sup>

The progress of Gorbachev's reforms encountered the persistent opposition of the entrenched officialdom of the Communist Party (obviously with some exceptions) and at the same time was joined by reformers, many of who went beyond Gorbachev and many of who sought to modify socialism in ways that challenged its essential character.<sup>26</sup> In the end, Boris Yeltsin took the play away from Gorbachev and pursued a course that was unabashedly capitalist (but was not proclaimed to be such).<sup>27</sup>

In the first year of his announced reform course, Gorbachev received little effective or articulate support from the Communist Party, as represented by the 27th Party Congress. But subsequently the Law on Individual Labor Activity and independent state quality control were adopted by the governing organs.<sup>28</sup> A little later, a draft Law on State Enterprises was published.<sup>29</sup> Reformers had been speaking of a law on socialist enterprises as an attempt to reduce the weight of central economic control agencies, but the results here were ambiguous.

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<sup>25</sup> See *id.* at 63–72.

<sup>26</sup> See Steven M. Spaeth, *The Deregulation of Transportation and Natural Gas Production in the United States and its Relevance to the Soviet Union and Eastern Europe in the 1990s*, 12 U Bridgeport L Rev 43, 92 (1991).

<sup>27</sup> See Dina M. Bernardelli, Note, *Russian Rule-Ette: Using Khodorkovsky's Criminal Trial to Assess the State of Russia's Judiciary*, 31 BC Intl & Comp L Rev 85, 86 (2008).

<sup>28</sup> See Amy J. Bliss, *Proletariat to Perestroika: A Comparison of Labor Law in the Soviet Union and the Russian Federation*, 18 Comp Lab L J 264, 286–87 (1997).

<sup>29</sup> See Kathryn Hendley, *Remaking an Institution: The Transition in Russia from State Arbitrazh Courts*, 46 Am J Comp L 93, 94 n 8 (1998).

Gorbachev continued his campaign, and, of course, despite the opposition his voice always commanded wide attention.<sup>30</sup>

A vigorous campaign against alcohol was instituted in 1985, but was so effective that it affected national income and was thereby a cause for concern.<sup>31</sup> In addition, quality control (of manufacturing)—a concern since the mid-1970s—had been strongly reinforced in 1985 but resulted in reduced production and therefore met with mixed approval and support.<sup>32</sup> Self-financing the use of funds generated by enterprises for investment where they were generated was also the subject of trial applications under Gorbachev. Of course, a dominant objective of the Gorbachev efforts was to increase the rate of economic growth, and this was written into the Five Year Plan adopted in 1985.<sup>33</sup>

The first real (and more fundamental) efforts at economic reform were adopted in 1987: a series of decrees surrounding the Law on State Enterprise, which were intended to democratize and decentralize the system and to leave more decision-making in the hands of the day-to-day managers and workers.<sup>34</sup> The output of enterprises was still to consist of some state orders fixed by the planners but otherwise what was produced and to whom it was sold were to be determined by the enterprises. Prices, however, largely remained under state control.<sup>35</sup> Thus, Gorbachev tried to introduce market concepts as part of his reform agenda. But shortages of consumer goods began to develop as the funds in consumer hands grew (partly from diversion of investment funds to employee compensation) and the amount of available goods being produced held steady or was reduced (and prices remained constant).<sup>36</sup> A sizable government deficit also developed as a result of declining revenues attributable to the anti-alcohol campaign, the 1987 Law on State Enterprise and other factors. The deficit was met by the printing of more money, which in turn added to the imbalance between supply and demand. At the same time the rate of investment declined because it was no longer dictated by the Plan and enterprises failed to take up

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<sup>30</sup> See Kotz and Weir, *Revolution from Above* at 78, 92 (cited in note 4); Anders Åslund, *Russia's Capitalist Revolution: Why Market Reform Succeeded and Democracy Failed* 54–56 (Peterson Institute for International Economics 2007).

<sup>31</sup> Consider Daniel Tarschys, *The Success of a Failure: Gorbachev's Alcohol Policy, 1985-88*, 45 *Europe-Asia Stud* 7 (1993).

<sup>32</sup> See Åslund, *Gorbachev's Struggle for Economic Reform* at 76–80 (cited in note 7).

<sup>33</sup> See Kotz and Weir, *Revolution from Above* at 77–82 (cited in note 4).

<sup>34</sup> See Christopher M. Pilkerton, *Changing the Chameleon: A New Approach to the Investigation of Transnational Organized Crime*, 10 *Intl Legal Perspectives* 247, 270 (1998); Åslund, *Russia's Capitalist Revolution* at 54–56 (cited in note 30).

<sup>35</sup> See Alexander Yakovlev, *Russia: The Struggle for a Constitution*, 7 *Emory Intl L Rev* 277, 283–84 (1993).

<sup>36</sup> See Bernard H. Siegan, *Conserving and Developing the Land*, 27 *San Diego L Rev* 279, 280 n 4 (1990).



the slack—apparently more concerned about today’s results than about tomorrow’s needs.<sup>37</sup>

Shortages of consumer goods—particularly basic ones—and diversion to the black market grew and the consumer crisis deepened. Moving far beyond Gorbachev’s original demands, radical economists and the media began to speak in terms of a “socialist market economy” and a “planned market economy,” implying that the economy should become *primarily* a market economy.<sup>38</sup> In 1990, the term *regulated market economy* came into use, perhaps suggestive of its use in a capitalist context. Finally, the term “free market” came into use, suggesting a state of affairs that did not really exist anywhere.<sup>39</sup> By 1990, the status of property was being argued in the media, with increasing support for private property and for a mixed economy, which would include small-scale cooperative and individual enterprises. Then there were demands for equal status for all forms of property. From here, discussion moved on to privatization, meaning the conversion of state enterprises into capitalist companies.<sup>40</sup> During this period, Gorbachev seemed to favor a faster pace for *perestroika* but he did not support the privatization of industry.<sup>41</sup> Meanwhile, Boris Yeltsin had been elected Chairman of the Supreme Soviet of the Russian Republic, where he was a rival to Gorbachev. A team of economists containing adherents of Gorbachev and Yeltsin produced the 500 Day Plan, which called for the drastic transformation of the Soviet economy in 500 days.<sup>42</sup> The Plan envisioned a great deal of privatization, encouraged foreign investment and called for a financial system based on private commercial banks and securities markets.<sup>43</sup> The Plan also called for the rapid freeing of many prices. It was moving without delay toward capitalism. At first Gorbachev seemed to agree to this Plan, but he later rejected it, while Yeltsin and the parliament of the Russian Republic approved it.<sup>44</sup>

Shortages of consumer goods became increasingly acute as output in the economy failed to grow and then contracted, investment dropped and the

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<sup>37</sup> See Jha, *The Perilous Road to the Market* at 24–33 (cited in note 1).

<sup>38</sup> See Kotz and Weir, *Revolution from Above* at 83–90 (cited in note 4).

<sup>39</sup> See *id.* at 85.

<sup>40</sup> See Frenkel and Sukhman, *New Foreign Investment Regimes of Russia and Other Republics of the Former U.S.S.R.* (cited in note 8) (noting that “[t]hroughout 1990, more than twenty pieces of legislation concerning companies, privatization, property, currency, and pricing were passed”).

<sup>41</sup> See Roger Barrett James, Comment, *Information—The Key to Fair Privatization: British Successes and Russian Pitfalls*, 20 Loyola LA Int & Comp L J 837, 858 (1998).

<sup>42</sup> See *id.* at 857–58.

<sup>43</sup> See *id.*

<sup>44</sup> See Kotz and Weir, *Revolution from Above* at 89–90 (cited in note 4).

budget deficit seemed beyond control.<sup>45</sup> It was an economic crisis. In 1991, the governments of the Soviet Union's Eastern European allies had fallen and their economies were reoriented toward the West, causing a sharp decline in Soviet foreign trade. At the same time, the republics in the borderlands of the Soviet Union were restive and breaking away, so Russia lost much of its area and some of its resources. While the Soviet Union was undergoing the trauma of reform, it was also suffering from external economic problems that added to its distress. Some of this had its origins in the chronic shortfall of collectivized agriculture and the need to import grain. This, in turn, resulted in a requirement for a countervailing export surplus. Since Soviet exports were primarily natural resources, and specifically oil and gas, export earnings were heavily dependent on the world oil price, which fluctuated widely in the 1980s and 1990s.<sup>46</sup> During this period, in addition, some of the Eastern European satellites of the Soviet Union had accumulated a heavy indebtedness to Western banks.<sup>47</sup> In order to meet the hard currency needs of its own citizens, a problem exacerbated by a low oil price, and the needs of its allies and socialist trading partners, the Soviet Union was in need of hard currency funds. This might be met by borrowings from Western sources or even by government aid from Western nations. In either case, the Soviet Union would have to maintain good relations with the West and deal with questions of economic reform and questions involving its non-Russian republics and their aspirations for independence in ways that were satisfactory to the West. The Soviets were thus not free to take measures that would antagonize the West, and their parlous financial condition made this quite clear. Gorbachev's pursuit of policies of detente fit in well with the prospect of financial aid from the West.<sup>48</sup>

### III. LEAVING SOCIALISM BEHIND

Yeltsin had been named Chairman of the Supreme Soviet of the Russian Republic parliament. In 1991, he won a popular election to become President of the Russian Republic.<sup>49</sup> Presumably, he favored movement toward capitalism, but this was not his electoral platform and polls at the time still showed majority popular support for socialism. There were several major strikes by coal miners from 1989–1991, and the coal miners supported Yeltsin. A referendum in 1991

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<sup>45</sup> Consider Michael Burawoy and Kathryn Hendley, *Between Perestroika and Privatization: Divided Strategies and Political Crisis in a Soviet Enterprise*, 44 *Soviet Studies* 371 (1992).

<sup>46</sup> See Jha, *The Perilous Road to the Market* at 23 (cited in note 1).

<sup>47</sup> See Kathleen Woody, *Soviet Banking and Finance* 103–51 (Woodhead-Faulkner 1990).

<sup>48</sup> See Kotz and Weir, *Revolution from Above* at 90–95 (cited in note 4).

<sup>49</sup> See Cindy Skach, *The "Newest" Separation of Powers: Semipresidentialism*, 5 *Intl J Const L* 93, 117 (2007).

showed strong popular support for preservation of the Soviet Union and a new Union treaty was negotiated granting important powers to the republics but preserving some sort of union. Before this treaty could be signed, conservative Communist forces, including the military, attempted a coup, placing Gorbachev under house arrest and moving troops into Moscow to attack the White House, the seat of the Russian parliament.<sup>50</sup> Boris Yeltsin led defending forces from the top of a tank and the coup was crushed in a few days.<sup>51</sup> This established the ascendancy of Yeltsin. Before the end of 1991, Gorbachev resigned as President of the Soviet Union. On December 31, 1991, the Soviet Union ceased to exist.<sup>52</sup>

In Russia, the Yeltsin government instituted “shock therapy,” the purpose of which was to move to capitalism as quickly as possible, and the results were, to say the least, shocking.<sup>53</sup> Price controls were immediately removed from most wholesale and retail prices—prices immediately tripled. Government spending was slashed.<sup>54</sup> Privatization of state-owned companies proceeded rapidly.<sup>55</sup> Within two years, most firms were in the private sector. Meanwhile, industrial production fell steeply across the board and price inflation proved very difficult to contain.<sup>56</sup> This, of course, resulted in large declines in income both by wage earners and pensioners. Despite the poverty visited on the mass of the population by shock therapy, a substantial elite (including many members of the former Party leadership and bureaucracy) profited immensely from the privatization process and from other aspects of the move into capitalism.<sup>57</sup> Under Yeltsin, a whole new class of wealthy oligarchs rose to prominence and became an important force in the economy.<sup>58</sup> All of this, of course, opened a huge wealth gap and much obvious inequality. These developments and the accompanying loosening of the political structure brought with them an upsurge

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<sup>50</sup> See Sam Blay, *Self-Determination: A Reassessment in the Post-Communist Era*, 22 Denv J Intl L & Poly 275, 288 (1994).

<sup>51</sup> See Kim Lane, *Guardians of the Constitution: Constitutional Court Presidents and the Struggle for the Rule of Law in Post-Soviet Europe*, 154 U Pa L Rev 1757, 1793 (2006).

<sup>52</sup> See Kotz and Weir, *Revolution from Above* at 131–55 (cited in note 4).

<sup>53</sup> See Bernard S. Black and Anna S. Tarassova, *Institutional Reform in Transition: A Case Study of Russia*, 10 Sup Ct Econ Rev 211 (2003); Steven A. Ramirez, *Market Fundamentalism's New Fiasco: Globalization as Exhibit B in the Case for a New Law and Economics*, 24 Mich J Intl L 831, 839 (2003); Åslund, *Russia's Capitalist Revolution* at 144–46 (cited in note 30).

<sup>54</sup> See Steve Campbell, Comment, *Brother, Can You Spare a Ruble? The Development of Bankruptcy Legislation in the New Russia*, 10 Bankr Dev J 343, 344 (1994).

<sup>55</sup> See Bernardelli, *Russian Rule-ette* at 86 (cited in note 27).

<sup>56</sup> See William J. Kovatch, Jr., Comment, *Joining the Club: Assessing Russia's Application for Accession to the World Trade Organization*, 71 Temp L Rev 995, 1022 (1998).

<sup>57</sup> See Campbell, *Brother, Can You Spare a Ruble?* at 344 (cited in note 54).

<sup>58</sup> See *id.*

of crime and lawlessness and the prominence of the Russian Mafia.<sup>59</sup> Eventually, after Putin succeeded Yeltsin, the media was subjected to increasing restrictions and the power of the oligarchs was crushed.<sup>60</sup> Much has been written about shock therapy and its supposed benefits, as well as its obvious painful costs. It is of particular interest in contrast to the generally more gradual approaches pursued in China. Recourse to shock therapy was attributed in part to the advice of the International Monetary Fund, Harvard advisers and, specifically, Professor Jeffrey Sachs. One of the impacts of shock therapy under the Yeltsin regime was the political revival of the Communist Party.<sup>61</sup>

It is difficult to appraise the extent to which the mass of the Russian people welcomed the transformation of their socialist economy to capitalism. Certainly, they did not celebrate shock therapy and it is impossible to know to what extent the growth of political freedom was sufficient compensation for whatever economic deprivation marked the transition to capitalism. Eventually, the influence of Putin and the effect of higher oil prices caused the economy to stabilize and indicators pointed to increasing public satisfaction. On the other hand, democracy was marginalized and political freedom (particularly as reflected in freedom of the press) was put under stress.<sup>62</sup>

In analyzing the causes and consequences of the collapse of socialism in the Soviet sphere and the reaction of the Soviet populace to this economic earthquake, one must be careful to distinguish the economic from the political since socialism in Russia brought with it the Leninist authoritarian state and, of course, there continues to be controversy whether socialism of the Soviet character necessarily implies a Leninist political structure. Communist economics is overwhelmingly unpopular in the West, but it has features that no doubt contributed to the limited acceptance that it enjoyed in the Soviet Union. One of those attractive features is the typically low level of unemployment.<sup>63</sup> The recent financial crisis in the capitalist world brought with it a level of unemployment that the public finds quite unacceptable, and in the much worse collapse in the Great Depression of the 1930s, widespread and severe unemployment brought about a rise in the popularity of socialism in the West

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<sup>59</sup> See Georgi Arbatov, *Origins and Consequences of 'Shock Therapy'*, in Lawrence R. Klein and Marshall Power, eds, *The New Russia: Transition Gone Awry* 171, 173–75 (2001).

<sup>60</sup> See Ethan S. Burger and Mary Holland, *Law as Politics: The Russian Procuracy and its Investigative Committee*, 2 Colum J E Eur L 143, 151–52 (2008).

<sup>61</sup> See Jha, *The Perilous Road to the Market* at 36, 65–66 (cited in note 1).

<sup>62</sup> See Andrew Jack, *Inside Putin's Russia: Can There Be Reform without Democracy?* 334 (Granta 2006).

<sup>63</sup> See Kornai, *The Hungarian Reform Process* at 81 (cited in note 11).

that has not been equaled since.<sup>64</sup> So, at least potentially, an attractive feature of socialism is the claimed absence of unemployment, which, barring very unusual conditions, seems to be an enduring tendency of a socialist economy.<sup>65</sup>

Other aspects of socialist economies that have evoked popular support have been free education (even at higher levels) and free medical care. So, although socialism of the Soviet genre has not generally achieved popularity in the West, it has from time to time exhibited economic aspects that many in the West have found appealing. However, the main grounds for Western abhorrence of Communism in the Soviet Union has been its Leninist political complexion and, in particular, the arbitrary authoritarian face that it has displayed to the world. The horrors of Stalin's homicidal terror, against which there is no guarantee in the Soviet system, are the ultimate examples of what was unacceptable in Soviet political practice. But even the much milder measures of lesser authoritarians have offended Western standards of human and civil rights.<sup>66</sup>

The key question, of course, is whether Marxist economics necessarily carries with it arbitrary and authoritarian politics.<sup>67</sup> One of Gorbachev's goals was the achievement of a more democratic socialism presumably recognizing the rule of law. There are many millions throughout the world today that would recognize this as a worthy and achievable goal. But I think one would have to recognize that there is a real question whether a genuinely socialist organization of the economy could survive in a genuinely democratic political environment. Certainly, there is no assurance that anti-socialist influences could be brought to heel by majority vote, and, in fact, the opposite is more likely: various aspects of socialism could be reversed by majority vote. This is one of the prime reasons that Lenin and his colleagues opted for authoritarianism in the first place. Of course, various regimes purporting to be socialist have survived in various Western countries. But none of these pursued a policy that really enforced ownership of industry exclusively by government with private ownership

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<sup>64</sup> See *The Economy: The Problem: Workingman's Blues*, *The Economist* 76 (July 26, 2008) (noting that unemployment during the Great Depression reached 25 percent); US Dept of Labor, Bureau of Labor Statistics, *Economic News Release: Employment Situation* (December 2009), online at [http://www.bls.gov/news.release/archives/empst\\_01082010.pdf](http://www.bls.gov/news.release/archives/empst_01082010.pdf) (visited Apr 30, 2010) (reporting that the US unemployment rate was 10 percent for November 2009).

<sup>65</sup> See Simon John Commander and Andrei Tolstopiatenko, *Why is Unemployment Low in the Former Soviet Union? Enterprise Restructuring and the Structure of Compensation*, World Bank Policy Research Paper No 1617 (1996), online at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=636122](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=636122) (visited Apr 30, 2010); Campbell, Comment, 10 Bankr Dev J at 386–87 (cited in note 54).

<sup>66</sup> See Kotz and Weir, *Revolution from Above* at 228–35 (cited in note 4).

<sup>67</sup> See Carol M. Rose, *The Several Futures of Property: Of Cyberspace and Folk Tales, Emission Trades and Ecosystems*, 83 Minn L Rev 129, 130 (1998) (noting the modern disillusionment with Marxist economics, which are associated with authoritarian socialist regimes).

prohibited. Whether such a regime could survive in a genuinely democratic environment is a more difficult question.<sup>68</sup>

Viewing matters from a slightly different perspective, one may ask whether a socialist regime is more likely to be successfully managed by an authoritarian or by a democratic government. As indicated above, Gorbachev's objective was at least in part to make the socialist economy in the Soviet Union more popular and successful by increasing democratic management.<sup>69</sup> At least, this was the goal of *glasnost* or openness—the dispersion of information about the functioning of government and the economy to the public. Gorbachev, of course, pursued other, more purely economic, reform goals, but never to the extent of abandoning what he thought to be basic socialist principles, like the public ownership of the means of production. But he was also committed to an underlying democratization of the economic process.<sup>70</sup> There are many, including his opponents at the time, who regarded his approach as a fool's errand, but there are many others who regard it as an attempt to achieve the ultimate potential of socialism.<sup>71</sup> How the dictatorship of the proletariat could be transformed into “true” democracy is never made clear.<sup>72</sup>

While the Soviet Union was engaged in efforts to perfect and/or to abandon socialism, its subject peoples in Europe were struggling to escape Russian tutelage and to dispense with Russian traditions of government. Led by Hungary in the intellectual sphere and Poland in the practical, these countries, which were essentially spoils of the Second World War, struggled and squirmed to establish their freedom. They looked beyond their most recent defeat in the Prague Spring in Czechoslovakia to engage in classic stirrings in Poland. The decisive element was the decision of the Soviets in the German Democratic Republic and elsewhere to keep Soviet troops in barracks and to refuse to intervene on behalf of Communist governments threatened by popular resistance.<sup>73</sup> Since the establishment and maintenance of these governments depended on the actual or potential armed support of the Soviet Union, withdrawal of support was decisive.<sup>74</sup> The loss of its Eastern European allies by the Soviets was followed by the fragmentation of the Union itself when various

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<sup>68</sup> See Kotz and Weir, *Revolution from Above* at 18–20 (cited in note 4).

<sup>69</sup> See Donna E. Arzt, *Due Process in the Appeal of Soviet Emigration Refusals*, 1 *Touro J Transnatl L* 57, 57–58 (1988).

<sup>70</sup> See Molly Warner Lien, *Red Star Trek: Seeking a Role for Constitutional Law in Soviet Disunion*, 30 *Stan J Intl L* 41, 87 n 230 (1994).

<sup>71</sup> See Kotz and Weir, *Revolution from Above* at 107–08 (cited in note 4).

<sup>72</sup> See *id* at 228–35.

<sup>73</sup> See generally Åslund, *Russia's Capitalist Revolution* at 63–67 (cited in note 30).

<sup>74</sup> See *id*.

borderland republics sought and achieved their independence.<sup>75</sup> These included the relatively wealthy Baltic republics of Estonia, Latvia and Lithuania, certain of the Transcaucasian republics and large Central Asian Muslim lands, leaving the Russian Republic with half of the population but still extending over numerous time zones from West to East.

So events following economic reform in Soviet Union not only brought about radical change in the organization of that state and its economy, but contributed directly or indirectly to an abrupt loss of its power and prestige in the world. Whether this collapse of the Soviet Union can be described as a “failure” of socialism in the same sense as Judge Posner has entitled his book a “failure of capitalism”<sup>76</sup> is, of course, questionable. That there was enough dissatisfaction with the Soviet economy (and government structure) in influential circles to lead to radical change is undeniable. There is still some debate between those who blame the system as reformed and those who believe that the reforms themselves (or at least some of them) were at the heart of the problem. The “end of history” school of thought seemed to believe that the collapse of the Soviet Union signaled the final defeat of socialism, marking the culmination of the final ideological battle of modern times.<sup>77</sup> Events since then, including what Judge Posner has called the “failure of capitalism,” have thrown some doubt on the finality and extent of socialism’s defeat, but the full significance of the demise of the Soviets is a conundrum that we are still struggling with (and is one of the primary points of this paper). Before we try to come directly to grips with this issue, we must digress to explore contemporary developments in China. As we shall see, one of the issues reflecting on the collapse of the Soviet Union that are raised by developments in China is whether the Soviets could have reformed their economy while retaining their authoritarian political structure.

#### IV. CONTEMPORARY EVENTS IN CHINA

Although China began, after the Communist seizure of power in 1949, to follow in general the Soviet path to socialism (but, in the parlance of the day, “with Chinese characteristics”), it soon introduced other variants of its own. These included letting the Hundred Flowers Bloom (temporarily permitting relatively free expression to the intellectuals) and the Great Leap Forward (attempting ultra-rapid growth of production), both of which followed the

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<sup>75</sup> See generally Åslund, *Russia's Capitalist Revolution* at 86–90 (cited in note 30); Kotz and Weir, *Revolution from Above* at 157–59 (cited in note 4).

<sup>76</sup> Posner, *A Failure of Capitalism* (cited in note 2).

<sup>77</sup> See Francis Fukuyama, *The End of History and the Last Man* (Harper Perennial 1993); Martin Jacques, *When China Rules the World: The End of the Western World and the Birth of a New Global Order* 4 (Penguin 2009).

directions of Chairman Mao, who was the ideological and strategic helmsman.<sup>78</sup> His final contribution was the Cultural Revolution, a drastic assault on the Communist Establishment and intelligentsia by youthful Red Guards seeking to upset conventional expectations.<sup>79</sup> The disruption attendant on the Cultural Revolution may have rendered suspect any radical adventures and certainly eased the way of those attracted by the “Capitalist Road.”<sup>80</sup> In any event, Mao died in 1976 and, after a struggle among his designated successors, events led to the recognized ascendancy of Deng Xiaoping. Like Mao, Deng was a member of the revolutionary generation. However, Deng was a person of a distinctly pragmatic orientation not given to visionary schemes like the Cultural Revolution. Like Gorbachev, Deng sought economic reform but steered clear of departures from Leninist governing principles—the Party and its designated leaders were in control. The flexibility of the Chinese in economic matters seemed to far exceed the Soviets, but, as indicated, China was disinclined to political experiments except at the local level.<sup>81</sup> Early in Deng’s regime, the Chinese rid themselves of the collectivized agriculture that had so long been the bane of the Soviets and turned essentially to family farming.<sup>82</sup> China also adopted a dual-track pricing system, under which there was a fixed price for all products produced under the plan, but production in excess of that was priced at market.<sup>83</sup> This was in line with Chinese inclinations to proceed with deliberation and caution and certainly to stay clear of shock therapy.<sup>84</sup> The Chinese also refrained from abrupt privatization—in fact, they struggled for ideological reasons over this issue and privatization failed to make real headway until the death of Deng in 1997.<sup>85</sup>

One feature of the Chinese reform was the growth of township and village enterprises, slipping occasionally into private ownership, but clearly marking the

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<sup>78</sup> See Patrick E. Tyler, *Deng Xiaoping: A Political Wizard Who Put China on the Capitalist Road*, NY Times A12 (Feb 20, 1997); Srinivasan, *Regulating the Belching Dragon: Rule of Law, Politics of Enforcement, and Pollution Prevention in Post-Mao Industrial China*, 18 Colo J Intl Envtl L & Poly 267, 285 (2007).

<sup>79</sup> David Ben Kay, Comment, *The Patent Law of the People’s Republic of China in Perspective*, 33 UCLA L Rev 331, 350 (1985).

<sup>80</sup> See Roderick MacFarquhar, *Mao’s Last Revolution* at 459–62 (Belknap 2006).

<sup>81</sup> Compare with Åslund, *Gorbachev’s Struggle for Economic Reform* at 89–104 (cited in note 7) (detailing Soviet experimentation under Gorbachev).

<sup>82</sup> See Benjamin W. James, Note, *Expanding the Gap: How the Rural Property System Exacerbates China’s Urban-Rural Gap*, 20 Colum J Asian L 451, 461 (2007).

<sup>83</sup> See Cyril Zhiren Lin, *Economic Reform in China*, in Victor Nee and David Stark, eds, *Remaking the Economic Institutions of Socialism: China and Eastern Europe* 116–21 (Stanford 1989).

<sup>84</sup> See Marlon A. Layton, Note, *Is Private Securities Litigation Essential for the Development of China’s Stock Markets?*, 83 NYU L Rev 1948, 1949 (2008).

<sup>85</sup> See Ian Johnson, *China’s Jiang Outlines Privatization Steps*, Wall St J A14 (Jul 31, 1997).



prevalence of gradualism. Another feature of the Chinese reform was the dedication of areas in certain Eastern coastal provinces as Special Economic Zones where foreign-owned factories and enterprises were invited to locate.<sup>86</sup> Whatever may have been the contrast in approaches between the Soviet Union and China, the differences in results were dramatic: the Soviet Union collapsed as a great power while China surged to prominence as perhaps the coming leading economic power in the world. What can account for this contrast in destinies of powers characterized as “socialist,” no matter what the specifics of their economic arrangements? As both these nations emerged into the new millennium, Russia—the principal remnant of the Soviet Union—was nominally, as well as substantially, capitalist, while China was moving in fact and function toward capitalist arrangements but clinging ideologically, in rhetoric as well as in many policy choices, to socialism. Originally, following the rhetoric of Deng, it officially claimed that it was pursuing a “socialist market economy.”<sup>87</sup>

No one has yet demonstrated conclusively that one cannot combine market pricing with socialist planning or that the public ownership of the means of production is not absolutely requisite to socialist claims. China seemed to try to pursue reform without any clear understanding of the boundaries of the socialist order that it was reforming. Its efforts proved to be amazingly successful if its annual rate of growth is a proper measure.<sup>88</sup> In 2000, it finally joined the World Trade Organization, thereby becoming intricately entangled in the world capitalist order. At about the same time, however, the leadership continued to be concerned about economic inequalities, not only those based on reformed economic arrangements, but those springing from differing degrees of regional development, with Western China lagging behind.<sup>89</sup>

The differences between the Soviet Union (and Eastern Europe) and China in adopting and reforming socialism are numerous, as are the cultural characteristics of these great nations upon which socialism was imposed. The Soviet Union had been subject to a socialist regime much longer than China (since 1917 in the case of the Soviets and since 1949 in the case of China) and, presumably, the patterns of thought and behavior associated with socialism were more deeply imbedded in Russia.

In China . . . , the market never ceased to exist. At the height of central planning in China, the state controlled the production and distribution of

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<sup>86</sup> See Chris Bramall, *Chinese Economic Development* 332–33 (Routledge 2008).

<sup>87</sup> See Christopher Hamp-Lyons, Note, *The Dragon in the Room: China's Anti-Monopoly Law and International Merger Review*, 62 Vand L Rev 1577, 1597 (2009).

<sup>88</sup> See Darya Haag, *Time to Pay the Dues or Can Intellectual Property Rights Feel Safe With the WTO?*, 8 Rich J Global L & Bus 427, 440 (2009).

<sup>89</sup> See Bramall, *Chinese Economic Development* at 482–83, 516–21 (cited in note 86).

only 500 products. The corresponding figure in the Soviet Union was over 20,000! Even for these 500 products, enterprises had developed an elaborate system of trading their above-plan output among each other. By the time economic reform came to industry in 1985, this had been institutionalized [sic] into semi-annual buyers' conferences where bewilderingly complex deals were regularly arranged. . . . Thus when reform came, China had both a substantial body of private and collective entrepreneurs, and a reservoir of experience with the market mechanism.<sup>90</sup>

Even before the 1917 Revolution, Russian agriculture had not been truly private, but the *mir*, the village commune, had been dominant. The collective and the state farm system under the Soviets had been one of the notorious weaknesses of its socialist system. In China, by contrast, collective agriculture had shrunk to the family farm (household responsibility system) in the early 1980s.<sup>91</sup> Thus, early in the transitional process Chinese reform moved significantly ahead of the Soviets. But even de-collectivization of agriculture was imposed across the whole of China only after it had been tested in selected areas first. This illustrates the gradualist approach that was mentioned earlier and contrasts with shock therapy as it came to the Soviet Union.<sup>92</sup>

One other aspect of the Chinese economic situation that differs markedly from the corresponding state of affairs in the former Soviet Union involves the place of manufacturing in the economy. China is now one of the foremost manufacturers in the world and is a major supplier of manufactured consumer goods to the US and many other countries.<sup>93</sup> By comparison, the Soviet Union before reform had great difficulty meeting quality standards in manufacturing necessary to become a significant factor in international trade. The Soviets' principal exports were raw materials—mainly oil and natural gas.<sup>94</sup> China is not nearly as rich in natural resources as the Soviets, so it could hardly expect to compete in the export of extracted materials.<sup>95</sup> However, as indicated, China more than compensated through export of manufactured products. Among

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<sup>90</sup> See Jha, *The Perilous Road to the Market* at 32 (footnotes omitted) (cited in note 1).

<sup>91</sup> Consider Susan Shirk, *The Political Economy of Chinese Industrial Reform*, in Victor Nee and David Stark, eds, *Remaking the Economic Institutions of Socialism: China and Eastern Europe* 328–50 (Stanford 1989).

<sup>92</sup> See Bramall, *Chinese Economic Development* at 338 (cited in note 86); Jha, *The Perilous Road to the Market* at 32 (cited in note 1).

<sup>93</sup> See *Trade in Commercial Services*, *The Economist* 46 (April 17, 2010) (observing that “China may have overtaken Germany to become the world’s largest exporter of goods in 2009[.]”); Peter Marsh, *China to Overtake US as Largest Manufacturer*, *Fin Times* (Aug 10, 2008).

<sup>94</sup> See Jochen Bethkenhagen, *Soviet Energy: Oil Exports Stabilise Thanks to Increased Natural Gas Production*, 22 *Econ Bull* 8 (2005).

<sup>95</sup> Indeed, China’s hunger for natural resources has drawn concern. See *China: The New Colonialists*, *The Economist* 58 (Mar 15, 2008).

other things, manufactured products are not nearly as sensitive to international price trends as raw commodities—a factor that contributed to the Soviet economic troubles of the late 1980s. In this respect, the Chinese economy seems more balanced in some fundamental respects than the Soviet economy. Granted, the Chinese were not as “advanced” or as industrialized as the Soviets. Thus, the Chinese economy remained more agricultural and less industrial simply because it had been less developed. But, in some respects, it probably can be regarded as more balanced and this may have helped it move beyond a more primitive socialism.

But the single most obvious distinction between the Soviet and the Chinese experience, of course, relates to politics rather than economics. The Communist Party is firmly in charge of economic developments in China while in Russia something resembling Western democracy prevails. One would hesitate to say that parliamentary democracy has become firmly entrenched in Russia, but what prevails there is an imperfect Western-style democracy rather than a one-party Leninist state.<sup>96</sup> But China remains an authoritarian state with a socialist economy undergoing reform, which seems to be moving it toward capitalism although it retains socialist characteristics.<sup>97</sup>

All this contradicts what had been the conventional wisdom several years ago. It was once widely held that reform in the direction of capitalism was enhancing the freedom of the society and exerting pressure toward more openness of the political system. The movement toward capitalism in China has continued but the society has exhibited no movement toward greater openness. In the Soviet circumstances, on the other hand, Gorbachev’s reform efforts included both the economic and the political and, in fact, *glasnost* (“openness”), was one of his watchwords. So the Soviet system eventually liberalized both economically and politically at more or less the same time. In China, on the other hand, Deng—who strongly advocated economic reform—was also a strong proponent of a firm hand in repressing the revolt that flared at Tiananmen Square.<sup>98</sup> Since that episode, there have been events that suggested some political liberalization, but also other developments that suggest the reverse.<sup>99</sup> Certainly, there has been no observable movement away from one-party authoritarianism, and experiments in democracy have been confined to the

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<sup>96</sup> See Derek E. Bambauer, *Cybersieves*, 59 Duke L J 377, 402–03 (2009).

<sup>97</sup> See Oliver Ting, Comment, *Pirates of the Orient: China, Film Piracy, and Hollywood*, 14 Vill Sports & Enter L J 399, 435 (2007); Ian Buruma, *Asia World*, NY Review of Books 56 (Jun 12, 2003).

<sup>98</sup> See Eric E. Orts, *The Rule of Law in China*, 34 Vand J Transnatl L 43, 60 (2001). See also Jacques, *When China Rules the World* at 211–12 (cited in note 77) (suggesting that typically democracy does not flower until after economic take-off).

<sup>99</sup> See Orts, 34 Vand J Transnatl L at 60–64 (cited in note 98).

provincial and local level. Nothing has occurred to suggest that an authoritarian regime was incompatible with an economy that offered an increasingly large role to the market.<sup>100</sup>

This state of affairs may provide a lesson for Gorbachev and others attempting to reform socialist economies. For reform proceeded successfully in China with very little change in the governing political structure. More importantly, there may be a question for the US and other politically liberal capitalist countries. Until now, it has been assumed that capitalism is the natural economic arrangement fitting comfortably with a liberal democratic political structure. But if China, a Leninist state, can surpass the West in some of the most currently conspicuous measures of capitalist success, what does this mean for the future of liberal democracy? Of course, the US remains in the lead with an economy twice the size of China's and a per capita GNP that is seventeen-fold greater.<sup>101</sup> But China is rapidly closing the gap by, for example, enduring the current setback in the global economy without registering negative growth and while maintaining extraordinary, if not sensational, positive growth. Moreover, China's public debt is less than one-third that of the US, which is almost two-thirds of its GNP. In light of these data, to put the matter bluntly: are we Americans too ill-disciplined to compete with an economy governed by authoritarians? China seems to have emerged from the recent (or current) downturn of the world economy in much healthier economic condition than the US or other Western democracies. If this is the case, it may be in part because its government has dealt more effectively with the conditions causing the decline. The decline may be in part a negative commentary on the ability of popular democracy to manage a problematic economy.

We, of course, competed for years with a socialist economy under authoritarian management (which we called Communism). We seem to have been successful in that competition. But now we are competing with a reformed socialist economy (that increasingly resembles capitalism) also under authoritarian management. What are our prospects in that competition? I hasten to add that I do not believe that we should scrap the Constitution in favor of a police state, but Chinese success in practicing a reformed socialism should give us pause. It certainly means that we must be more disciplined in the regulation of our economy, and it may well mean that there must be a larger governmental management element in the way we approach economic matters. There must be

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<sup>100</sup> See Joseph Fewsmith, *China since Tiananmen* 258–63 (Cambridge 2008); Jacques, *When China Rules the World* at 213–14 (cited in note 77).

<sup>101</sup> World Bank, *Gross national income per capita 2008* (Apr 19, 2010), online at <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GNIPC.pdf> (visited Apr 30, 2010) (China's GNI per capita is \$2,770 USD, the US's GNI per capita is \$47,580 USD).

a stronger artificial aspect to our economic arrangements and less reliance on what we think of as natural. The idea that the unguided market will always produce the best result simply does not square with the success of the Chinese reformed socialist state. Authoritarianism may not be the order of the day, but I think a larger role for government is.

## V. ECONOMIC DECLINE IN THE UNITED STATES

This brings us to a brief review of how the economic decline in the capitalist world (and specifically in the US) compares with developments in what was, and to some extent continues to be, the socialist world. The downturn of Western economies began with a global credit crisis: a drying up of credit such that borrowed funds became generally unavailable, even to potential debtors having the highest credentials.<sup>102</sup> The roots of the crisis lay in over-leveraging: too much debt was incurred and, in particular, too much low-quality debt carrying a high risk of default. For example, consider the subprime mortgage, an extension of credit to purchasers of homes having credit ratings below what would normally be required.<sup>103</sup> Mortgage bankers would extend such loans at the local level. Numerous such loans would then be packaged and sold as mortgage-backed securities to other credit institutions (in a process called securitization) thus mobilizing extensive credit resources in the process of home financing. One form of mortgage-backed security was the so-called collateralized debt obligation and the process of securitization was generally welcomed as a means of spreading risk on a national and international basis.<sup>104</sup> However, remote financiers, distant by several credit transactions from the local extender of home credit, received no notice that the mortgage-based securities that they had acquired might carry an unusually high risk of default. Risk of default thus spread extensively through the financial system but could not be easily identified, and it eventually led to a freezing of credit.<sup>105</sup> These problems were exacerbated by the extensive use of credit derivatives—credit default swaps and other credit derivatives—originally as insurance against default, but eventually as creating their own unanticipated and unknown risk.<sup>106</sup>

It is of some interest to compare the specific problems that afflicted the US's economy with those affecting China. As noted, the US endured a banking (credit) crisis closely related to a housing (mortgage) crisis, associated with falling

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<sup>102</sup> See *World Economy: Accelerating Downhill*, *The Economist* 48 (Jan 17, 2009).

<sup>103</sup> See *Debt Markets: Another Pounding*, *The Economist* 42 (Jul 14, 2007).

<sup>104</sup> Consider Steven L. Schwartz, *The Alchemy of Asset Securitization*, 1 *Stan J L Bus & Fin* 133 (1994).

<sup>105</sup> See *Securitisation: When It Goes Wrong*, *The Economist* 11 (Sept 22, 2007).

<sup>106</sup> See Posner, *A Failure of Capitalism* at 1–40 (cited in note 2).

housing prices. China was not afflicted with either of these specific problems. Among other things, its banks were owned by the government and were required to lend, so there could be no comparable credit freeze. And the monetary authorities had not driven down interest rates to stimulate housing activity and to raise housing prices. China was not affected by these specific problems but its export-driven economy was slowed by the worldwide recession.

Another major source of instability in the economy of the US and other capitalist countries was a general inadequacy of reserves to back the vast proliferation of debt and pursuit of leverage—leverage being defined as the ratio of debt to equity in any particular enterprise. Inadequacy of reserves seemed to be a general problem throughout the banking system and related financial enterprises—such as insurance. Debt ratios in some investment banks had grown as high as 30:1.<sup>107</sup> This, of course, made such key institutions vulnerable to unexpected financial demands, such as those resulting from debt defaults.<sup>108</sup>

In part, this financial crisis was the product of the reaction to an earlier crisis—the “dot-com” bubble.<sup>109</sup> In the 1990s, the stocks of companies related to computers and to the Internet had risen to fantastic levels, and the subsequent collapse left the economy in shambles. In order to alleviate the ensuing downturn, the monetary authorities lowered interest rates to minimal levels, thereby triggering a boom based on housing and construction.<sup>110</sup> Housing prices had risen rapidly and homeowners were encouraged to borrow more heavily on their homes, increasing the amount of consumer debt that was secured by inflated real estate values. Thus, the consequences of one bubble had been “cured” by the creation of another bubble—the housing bubble.<sup>111</sup> The second bubble is seen as a cure for the economic malaise that arose in the wake of the bursting of the earlier bubble. This phenomenon is to be distinguished from a normal and natural feature of capitalism—the business cycle. The business cycle is not devised by monetary authorities as a cure for economic malaise, but is characterized by the cyclical over-expansion of inventories and their subsequent liquidation as demand accelerates and slows, and is accompanied by fluctuation of prices. The business cycle is thus not an artificial

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<sup>107</sup> See S. Murlidharan, *Stress Tests Won't Help US Banks* (The Hindu Business Line, June 11, 2009), online at <http://www.blonnet.com/2009/06/11/stories/2009061150310900.htm> (visited Apr 30, 2010).

<sup>108</sup> See Posner, *A Failure of Capitalism*, at 43 (cited in note 2).

<sup>109</sup> See Howard Kurtz, *Who Blew the Dot-Com Bubble? The Cautionary Tale of Henry Blodget*, Wash Post C1 (Mar 12, 2001).

<sup>110</sup> See Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 NC Bank Inst 5, 13–15 (2009).

<sup>111</sup> See *You Can Almost Hear It Pop*, NY Times Sec 4 Page 11 (Dec 16, 2007); see also Jacob Werrett, Note, *Achieving Meaningful Mortgage Reform*, 42 Conn L Rev 319, 325 (2009).

response to economic ailments but a natural rhythm of business, which can perhaps be modified but would be very difficult to eliminate, even if elimination were desirable.<sup>112</sup>

Actually, the measures invoked by government to deal immediately with the recession in the US were similar to those put in force in China. A stimulus package was brought to bear in both countries involving the spending of large sums of money on various projects to improve the infrastructure and otherwise as a means of broadly increasing demand and creating jobs. In the US, there was also a program to provide funds for banks and other financial institutions in danger of failure. This was a measure not needed in China, where the government owned these institutions and guaranteed their solvency.

Several factors are involved in the vulnerability of capitalism to destabilizing events and trends. One of these is the absence or inadequacy of regulation. Regulation is the intervention of government in the workings of the economy and, of course, is inconsistent with the reliance of a thoroughly capitalist economy on market forces to maintain stability. The balance of government regulation and market forces is well illustrated in the role of mortgages in the housing market. For example, the role of subprime mortgages—so prominent in the recent downturn—demonstrates how government regulation may be necessary as an aid to or corrective of market forces. The risk of loss inherent in lending mortgage money to bad risks or on terms unlikely to be honored should in theory deter these practices. But in practice, the belief that property values could only rise seemed to drive caution from the minds of participants in these markets, and it may be time to legislate against engaging in excessively risky mortgage practices. Whatever regulation has previously been applied to mortgage practices has probably been designed to loosen lending standards, to make credit more broadly available rather than to avoid excessively risky practices. But now the time may have arrived to use regulation to avoid risk.<sup>113</sup>

In any event, the typical capitalist faith in the “invisible hand” of the market has been shaken by recent events and the door has been opened to more and stricter regulation. Those who adhere to the gospel of the free market will protest that excessive regulation will stifle the creative impulses of capitalism and in the end attach an anchor to economic growth. Here, however, there must be balance. Capitalism is characterized by creative destruction but it is inevitably also threatened by instability, and some middle course must be sought between

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<sup>112</sup> See Posner, *A Failure of Capitalism* at 1–4 (cited in note 2).

<sup>113</sup> See *id.* at 241–43, 289–90, 320–21 (cited in note 2).

these tendencies.<sup>114</sup> Another inevitable problem of capitalism is inequality. The free market left to its own devices tends to pile up rewards for the already rewarded; the rich become richer.<sup>115</sup> This is not only the talents of the successful tending to be displayed again and again as the game continues and wealth flows to the talented acquirers who have become wealthy; there is also something in the workings of the market itself which tends to bring its fruits to those who have won them in the past. Under capitalism, government must therefore act to restore equality. Thus, through taxation, access to welfare benefits and otherwise, government seeks to remedy the inequalities of capitalism by the redistribution of the wealth, frequently mild and occasionally severe.<sup>116</sup>

This leads us to an effort to draw lessons from a comparison of the respective economic events and developments that we have described. What conclusions may be drawn from the wrenching demise of socialism in Russia, the apparently robust survival of something called socialism in China, and the decline and severe wounding of capitalism in the US and in the West? Of course, as we have seen, all these phenomena were so unlike one another that comparisons may be of limited value, but I think some observations are in order and can be illuminating.

For example, socialism and the regime that maintained it in Russia were started on the road to extinction by the conscious design of a leader legitimately emerging from the system—an ultimate insider. Gorbachev's policy was drawn from some dissatisfaction with the recent slowing rate of growth of the Soviet economy (although growth had not been a long-term problem) and perhaps by a degree of disapproval of the arbitrary nature of Soviet politics. But Gorbachev certainly did not have in mind the death of socialism when he undertook *perestroika* and *glasnost*. Quite the contrary. He intended to reform and to preserve socialism in a purer form and in a democratic setting.<sup>117</sup> But the reforms he pursued helped to unleash forces that eventually brought socialism to an end. And to some extent (but this remains, to various degrees, arguable), the reforms themselves produced unfortunate economic effects that eventually hastened the decline into what eventuated as capitalism. To some degree, both in the former

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<sup>114</sup> See Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy* 84 (George Allen & Unwin 1976) (describing capitalism as an economic ideology characterized by creative destruction); *A Special Report on the World Economy: Taming the Beast*, *The Economist* 66 (Oct 11, 2008) (discussing the question of whether modern finance is inherently unstable).

<sup>115</sup> Consider Paul Krugman, *For Richer: How the Permissive Capitalism of the Boom Destroyed American Equality*, *NY Times Magazine* 62 (Oct 20, 2002).

<sup>116</sup> Åslund, *Russia's Capitalist Revolution* at 52 (cited in note 30).

<sup>117</sup> See Yakovlev, *Russia: The Struggle for a Constitution*, at 283–84 (cited in note 18); Åslund, *Gorbachev's Struggle for Economic Reform* at 182–87 (cited in note 7); Kotz and Weir, *Revolution from Above* at 152 (cited in note 4).



Soviet Union and in China, the emphasis of reform came to be placed on the restoration of the market as the central device for the management of the economy. Underlying the movement toward reform was some kind of idea that socialism could survive (and be improved) with a greatly enhanced role for the market. In the end, this idea proved to be a sort of squaring of the circle. The market could be flirted with and given a part and ultimately became a sort of salvation. But in the end it proved subversive and very hard to digest in a system still capable of being called socialist.<sup>118</sup>

The immediate, and to some extent continuing, verdict on the Soviet collapse was that it showed that socialism was no longer a plausible factor in world economic thinking—leaving capitalism without rival. Socialism had lost and capitalism had won. As Judge Posner has put it: “[Capitalism] will survive because there is no alternative that hasn’t been thoroughly discredited. . . .”<sup>119</sup> But the ringing confidence with which such verdicts could once be pronounced has been muted by the present difficulties of the capitalist world. Inequality—the great blight of even successful capitalism—and unemployment—the bane of capitalism in decline—remain as reminders that capitalism is not paradise and leaves some thinkers still hankering after socialism. To many of the hankerers, the answer is democratic socialism, socialism without Lenin. This presumably would provide the full employment of the Soviet state but without the horrors of the police state. But the Chinese experience may be an obstacle to this thinking. The Soviets sought to reform socialism while loosening the bonds of the authoritarian state. Their path was rough and their progress halting. Their country was shaken to its roots before they emerged with imperfect capitalist arrangements.<sup>120</sup> The Chinese, on the other hand, undertook reform, imposed from the top but under firm authoritarian control throughout.

Whatever may be said about China from a broader humanitarian viewpoint (and here a more critical outlook is certainly in order), its political approach more successfully negotiated economic change while maintaining growth than did the Soviets. To the extent China may be said to have preserved a socialist element in its economy, the controlling role of its government in economic affairs must probably be recognized as the most prominent remaining feature of socialism. It is significant that the people in charge are members of the Communist Party and in principle, if not in practice, advocates of socialism. In Russia, on the other hand, something resembling parliamentary democracy

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<sup>118</sup> Åslund, *Gorbachev's Struggle for Economic Reform* at 59–67 (cited in note 7).

<sup>119</sup> Posner, *A Failure of Capitalism* at 234 (cited in note 2). But see Kotz and Weir, *Revolution from Above* at 234–35 (cited in note 4) (arguing that a “distorted version of socialism, not socialism *per se*” failed).

<sup>120</sup> See Kotz and Weir, *Revolution from Above* at 224–35 (cited in note 4).

prevails. But whatever remains of socialism is hard to recognize, although some remnants may perhaps be found.

In modern times, socialist sentiment is expressed primarily in advocacy of social democracy, the preference for the welfare state. This involves the provision of benefits to cushion the hardships of industrial society, such as illness and unemployment. Universal health insurance is widely provided and long-term unemployment insurance is a standard offering. Education is widely available and within economic reach. Welfare state benefits are broadly provided in Western Europe and provide a fairly sturdy social safety net.<sup>121</sup> This sort of social security is entirely consistent with political democracy and this combination of economic and political arrangements generally prevails in Europe.<sup>122</sup> These arrangements preserve the egalitarian aspirations of socialism and go a long way toward meeting the security assurances associated with socialist thinking.<sup>123</sup> The welfare state, of course, does not meet the principled demands of socialist thinking.<sup>124</sup> The means of production may not be publicly owned, and the economy may not be extensively planned.<sup>125</sup> But the redistribution of wealth and income is a serious goal of government policy.<sup>126</sup> This seems to mean that pre-Marxist ideas of socialism have survived better than class warfare, the dictatorship of the proletariat, the labor theory of value and other specifically Marxist concepts.

The economic debate in the US still revolves around the desirability of extensive welfare provisions and the other features of social democracy and, of course, the sort of taxation that has to accompany them. Hard-core conservatives resist these notions with passion<sup>127</sup> and cherish the view that Europe will not experience real prosperity until it rejects what they regard as curbs upon economic growth.<sup>128</sup> People of this view may have been dismayed

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<sup>121</sup> See, for example, *Economics Focus: Voting for Welfare*, *The Economist* 100 (June 2, 2001).

<sup>122</sup> See *id.*

<sup>123</sup> See Ronald Daniels and Robert Howse, *Reforming the Reform Process: A Critique of Proposals for Privatization in Central and Eastern Europe*, 25 *NYU J Intl L & Pol* 27, 29–30 (1992).

<sup>124</sup> See, for example, John Edward Cribbet, *Concepts in Transition: The Search for a New Definition of Property*, 1986 *U Ill L Rev* 1, 2 (1986) (noting that the welfare state does not adopt socialist ideals of “public property”).

<sup>125</sup> See Harry W. Jones, *The Rule of Law and the Welfare State*, 58 *Colum L Rev* 143, 144 (1958).

<sup>126</sup> See Steven R. Ratner, *Regulatory Takings in Institutional Context: Beyond the Fear of Fragmented International Law*, 102 *Am J Intl L* 475, 497 (2008).

<sup>127</sup> See, for example, *Crowds Air Grievances at Rallies from Coast to Coast*, *Chi Trib* 4 (Apr 16, 2010) (describing the protests being undertaken by the small-government, Tea party).

<sup>128</sup> See, for example, Greta Van Susteren and Newt Gingrich, *Most Radical President in History?* (Fox News Apr 12, 2010), online at <http://www.foxnews.com/story/0,2933,590822,00.html> (visited

when welfare-state economies proved somewhat more resilient in the face of the economic turndown than economies not undergirded with a protective net. Presumably, the provision of income and benefits for the needy protected society against the worst ravages of an economic slowdown. As indicated, the welfare state implemented the aspirations and concerns of socialism without putting the validity of its theoretical underpinnings to the test. How far capitalism may stray from its ideal form in the direction of welfarism without losing its dynamism will remain the subject of debate, but it is fair to say that some form of social democracy is as close to socialism as any economy is likely to get in the near future.

Perhaps, the most interesting question at the moment is the future of the Chinese economy and its role as a model for others. Its present success is so dramatic that others may well seek to emulate it. Whether emulation will include adoption of Leninist one-party government may be questionable. But that question is likely to be raised by aspiring imitators. In the perspective of history it may turn out that China is driven by factors which we have not subjected to scrutiny and which are unique to China for reasons currently unperceived. It is likely that in the long run China will not practice classical capitalism or classical socialism but will follow a path of its own, subject both to government guidance and to the unseen hand of the market. A central concern of the Chinese state has always been the need to keep the nation together and to avoid fragmentation, particularly in the uniquely Chinese form of warlordism. As far as government is concerned, it is likely that China will be influenced as much by its fear of fragmentation as by the needs of its economy. This concern suggests a strong central government, whatever else may be involved. That much is probably foreordained.

## VI. CONCLUSION

Thus, the effort of the Soviet Union, the socialist pioneer, to transform its economy led immediately to disaster and eventually to a diminished role as a power and to abandonment of the socialist creed. Similar efforts by a socialist China moved it from the status of "Sick Man of East Asia" to economic preeminence and potentially to dramatic enhancement as a power and even to cultural leadership in the world. Meanwhile, the leadership of the US in almost all areas was compromised by an unforeseen failure of regulated capitalism.

The ruling ideologies of these major powers gave few clues of their fates in the process of change. Both leading socialist powers were engaged in transition giving a greater role to the market, but China moved in a way under firm

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Apr 30, 2010) (decrying the democrats' "goal of moving the country towards a European-style socialist welfare state model").

political control, while the Soviets pursued contemporaneous political change and their course wavered as a consequence. Beyond this, however, there is reason to believe that China was better prepared by experience to adopt a larger role for the market than the Soviet Union. At the same time, the US, the leading capitalist power, with a relatively unregulated market economy, demonstrated the inherent flaws of that approach by falling into a credit crisis and a consequent major recession. All in all, the path to future dominance seems, for the moment, to lie in China.

