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The Present and Future of Comparative Economic Systems: From the Perspective of New Structural Economics

Justin Yifu Lin

Abstract： Bruno Dallago and Sara Casagrande, editors of the forthcoming Routledge Handbook of Comparative Economic Systems, post four questions, which in their view summarize critical aspects of the discipline of comparative economic systems and the world in the present and the future, and invite a group of six prominent experts to write their responses to be included in the final chapter of conclusions, aiming at outlining the track of future development of the discipline of comparative economic systems.

I am honored to be among the invitees. The followings are their questions and my responses.

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Question I: Various events in the last three decades – from the actual outcome of the transition process in Central-Eastern Europe through the rise of China and other emerging economies to the international crisis and the Covid-19 pandemic – have revealed that the standard approach to economic analysis and policy making is insufficient to understand and govern economies in an age of rapid and deep changes. What could the study of Comparative Economic Systems offer to a better understanding and governance of the world economies and the advancement of economic analysis?

Response: Economic research is for the purpose of understanding the nature and causes of the researched subject so as to guide people's actions related to the subject for social betterment. Comparative Economic Systems (CES) as a subfield of modern economics, emerging from the research on comparing socialism and capitalism, contributed greatly to the understanding of poor performance of socialist planning system and gave supports to the capitalist triumph (Wiles 1995). The big-bang transition to market economy, influenced by the neoliberalism and following the Washington Consensus recommended by mainstream macro-economists, in Central and Eastern Europe and Former Soviet Union in 1990, resulting in economic collapse and prolonged stagnation (Easterly 2001, Lin 2014). The socialist planning economies in East Asia, including China, Vietnam and Cambodia, did not follow the prevailing Washington Consensus in their transition, instead they adopted a piecemeal, gradual approach. Such a half-hearted approach was considered a worst transition strategy, destined to worsen the economic performance (Murphy, Schleifer and Vishny 1992). Unexpectedly they achieved stability and dynamic growth during the transition. The contrast of performance between these two transition strategies highlights the incapability of mainstream economics as a discipline for system reform advice (Murrell 1991).

The studies of CES, following the convention of neoclassical economics, take the socialist planning system and its constituent institutions, such as financial repressions, administrative allocation, soft budget constraint and etc., as exogenous and analyzed primarily their impacts on economic performance. The institutions in the socialist planning system appeared to be distortions compared to ideal market institutions in neoclassical economics. However, they were adopted for the purpose of supporting nonviable firms in the priority sectors for building up advanced capital-intensive industries in an economy relatively scarce in capital (Lin 2009; Lin, Fang and Li 1994). Those institutions were interrelated and endogenous to the state's development strategy and thus second-best in nature. Without addressing the causes of those "distortions", the attempt to eliminate them in the transition is bound to deteriorate economic performance (*Lipsey and Lancaster, 1956)*.

Countries at different stages of development have many institutions that appear to be distortions from the perspective of neoclassical economics and even new institutional economics, however, they exist for good reasons. If economists of New Comparative Economics (Djankov et al. 2003, Douarin and Havrylyshyn 2021) hope to do well and do good as well, their studies should focus on not only the impacts but also the causes of those institutions and how to accomplish Pareto-improvement reforms in a second-best environment (Rodrik, 2008).

Question II: Institutions, both formal and informal, differ through countries. Their change through reforms is complex and often difficult. One important issue in explaining such difficulties and surprises of reforms and policy making is that institutions come in bundles and are under the influence of non-economic factors. How can the study of Comparative Economic Systems and the use of a systemic perspective contribute to better understanding the complexity of reforms and ease reform and policy making at national level in a strongly interdependent world? Or can surprises and difficulties be disentangled by better considering non-economic factors?

Response: Based on the new structural economics (NSE), which reflects the spirit of Marxism's historical materialism and uses the neoclassical approach as its tool for analysis, the economic system in an economy consists of a set of interrelated structures, including endowments structure, production (industries and technologies) structure, infrastructure and superstructure, or alternatively, in new institutional economics' terminology, institutions including formal ones such as laws, rules, and economic, social, and political institutions, and informal ones such as behavior patterns, traditions, beliefs, values and ideology; the production structure in an economy is endogenous to the economy's endowments structure, which is given at any specific time and changeable over time, because the endowments structure determines the economy's comparative advantages and thus the appropriate technologies and industries; and different technology and industry have different technical features, such as requirements for specific capital, skill and infrastructure, and economies of scale and risk, and thus to unleash the productivity of technologies and industries in a production structure, proper infrastructure and superstructure are required, therefore, the appropriate infrastructure and superstructure are endogenous to the production structure and indirectly to the endowments structure of the economy (Lin 2011a).

For an economic system to function well in a country, two fundamental institutions are essential, a competitive market and a facilitating state. The former is needed for providing incentives and relative prices information to guide entrepreneurs' production (industry and technology) choices according to the economy's comparative advantages and the latter, which is the only institution with a legitimate power to use coercion in the country, is needed to overcome inevitable market failures arising from externalities of innovation and coordination for the needed improvements in infrastructure and superstructure in the process of development, characterized by structural transformation (Lin 2011a).

There are two main sources of structural disequilibrium in an economic system in the modern world with cross-border flows of ideas, information and trade. The first is that the constituent structures in an economic system have different rigidities. The endowments structure will change quickly, if the economy has appropriate production structure, infrastructure, and superstructure in view of endowment structure because with such ideal structures in the system the growth of the economy and the accumulation of capital will be fast, triggering the change of relative weight of capital in the endowments structure and comparative advantages of the economy, calling for subsequent changes in production structure, infrastructure and superstructure. The change in superstructure, especially informal institutions such as behavior patterns, traditions, beliefs, values and ideology, is most sluggish. When the change in endowments structure happens, owing to the accumulation of capital as discussed above or other sources such as population growth, education, migration, foreign capital inflow or new discovery of natural resources, structural disequilibrium will arise if the changes in the upper-level structures do not synchronize with the change in the lower-level structures. The second source of structural disequilibrium may arise from the state's interventions in the production structure such as the adoption of structuralist comparative-advantage-defying import substitution strategy in the socialist as well as many other developing countries after the World War II (Lin 2009) or from the inheritance of, or model after, the political, legal and other formal institutions of advanced countries in the developing countries when obtaining political independence or after some social/political turmoil often with educated elites' aspiration, advice from multilateral development institutions or influence of global powers. Those first-order interventions from the state, like throwing a pebble in a pool, will lead to the emergence of other second-order ripple-like institutions. Both types of structural disequilibrium will result in poor economic performance and even social, political instability.

The restoration of structural equilibrium will be somewhat straight forward for the disequilibrium from the first source because the condition for change is ready as long as the state or some business/political/institutional entrepreneurs provide leadership and coordination for the change (Lin 1989). For the transition to restore structural equilibrium arising from the second source of state intervention, it is crucial to recognize that many seemingly distorted second-order institutions in the economic system, originating endogenously from the state's first-order interventions in production structure or superstructure, are second best in nature as discussed in my response to Question I, and thus it is desirable to adopt a pragmatic approach to avoid systemic upheaval and prepare conditions in the low-level structures before reforming those institutions in the upper-level structures so that a Pareto improvement may be achieved in the process of transition. For example, the removals of financial repression and soft budget constraint, which resulted from the need to protect nonviable firms in the structuralist import-substitution strategy's priority sectors, should wait until the nonviable firms become viable from the accumulation of capital and change of comparative advantages made possible by fast growth of comparative-advantaging-conforming new sectors in a gradual, dual-track transition (Lin 2009, 2014). For developing countries with imposed formal institutions of advanced countries, they may overcome this type of structural disequilibrium if they happen to have enlightened political leaders as those in the catching up stage of East Asian economies after the World War II, with the wisdom of exercising their discretionary powers to maintain political stability in their countries on the one hand and using the window of opportunity from political stability on the other hand to develop their economies dynamically so as to upgrade their economic base to meet the required conditions for the well-functioning of imposed institutions and for elimination of institutional conflicts with old informal institutions such as nepotism and second-order distortions such as patronage (Lin 1989, 2009).

Question III: Innovation and technical progress are perhaps more important than in the past for the competitiveness of enterprises and economies. This is due, among others, to the integration of economies and the consequent need to better coordinate macro-policies. As a consequence, the importance of the context for innovation – including particularly technological innovations, organizational innovation and social innovation - is increasingly important and this highlights the critical significance of the economic system and its features. Incremental innovation and path-breaking innovation are apparently the preferred domain of different countries, as much as labor mobility and investment of human capital are. In which sense and how can the economic system support the innovation in enterprises and of countries and how can the study of Comparative Economic Systems highlight and explain the different working of markets, the performance of enterprises and countries in innovation?

Responses: Innovation embodied in swift technological progress and industrial upgrading is the foundation to trigger sweeping structural changes and make an economy transformed from a stagnant traditional agrarian economy to a dynamic modern economy (Kuznets 1966).

For a developed country, the innovation means implementation of new invention and sometimes path breaking because its technologies and industries have already been in the global frontiers. Historical evidence shows that the advanced countries achieve on average 2 percent growth in per capita GDP annually since the mid-19th century (Maddison 2006). Developing countries with different economic systems may have different performances in terms of allocative efficiency equity, health, and other dimensions of development. However, a developing country, no matter with what type of economic system, has the potential to grow faster than advanced countries due to the existence of both advantages of backwardness, which refers to the lower opportunity cost of adopting a new vintage of technology directly in its upgrading to a new industry while the advanced countries need to retire the old vintage before adopting the new vintage (Gerschenkron 1962), and the latecomer advantages, which refers to the possibility for a developing country to borrow better, often mature and not necessary new, technologies from advanced countries at a cost lower than reinventing it (Lin 2016).

No matter with what type of economic system for a developing country to tap into the above two potential sources of rapid growth, the country's enterprises must carry out their innovations according to changes in the economy's comparative advantages so that they have production costs advantage in domestic and international markets and the state needs to play a facilitating role for compensating the first mover's externality and overcoming bottlenecks in infrastructure and related institutions in the superstructure so as to reduce transaction costs and turn the comparative advantages from "latent" to "actual" (Lin and Monga 2012). Due to the constraints of available resources and implementation capacity, the state in a developing country with overall poor infrastructure and business environment in the economy needs to play its facilitating function pragmatically (Lin 2011b, 2017). One feasible strategy is to target industries of the country's latent comparative advantages in its investment promotions and building special economic zones to provide adequate infrastructure and business environment in the enclaves for the targeted industries so as to jumpstart a dynamic growth and pave the economic foundation to expand the infrastructure improvements to other parts of the economy and trigger transformations in upper structures. With this pragmatic approach, there is a hope that any country with whatsoever economic system can grow dynamically (Lin and Monga 2017).

In view of the advancement of artificial intelligence in the Fourth Industrial Revolution and the coming of automation age with robots replacing labor in most industries, the developing countries should strive to grow as fast and accumulate capital, both financial and human, as much as possible by improving their infrastructure and reforming their institutions to turn their existing comparative advantages from latent to actual so that they will have sufficient capital and conducive environment to employ robots in industries of their comparative advantages, generate sufficient decent jobs in other activities for the labor replaced by robots and maintain competitiveness in the globalized world when the era arrives, just like what happened in the previous generations of industrial revolution, also featured by labor-saving and/or labor-replacement technological changes.

Question IV: In recent years inequalities within countries have been significantly increasing, although inequalities among countries decreased in various significant cases. At the same time, social and intergenerational mobility slowed down. Within enterprises and in the economy at large, efforts were concentrated on the attempt to attract highly mobile capital to the disadvantage of labor. At the same time, the increasing importance of knowledge and specialized skills created a growing split among employees to the disadvantage of low-skill workers. How far can the lack of a systemic alternative, such as the Soviet Union and socialist countries in the past, explain the greater cohesion of societies and the lack of governance of globalization that generated some of these effects? Can the revival of external threats in the form of the pandemic, the climate and environmental emergency and (for Western countries) the emergence of China (and viceversa for China) help move governments to better manage and ease those effects? Should the study of Comparative Economic Systems deal more with these issues?

Response: To achieve dynamic economic development with continuous improvement in income distribution, that is the common prosperity advocated by President Xi Jinping of China, is a dream for any nation.

Countries with different economic systems may put different policy weights on efficiency and equity due to their value or ideological reasons. From the perspective of new structural economics, the best way to achieve a dynamic, sustainable and inclusive growth in a country is to follow the following principles: 1) to develop a country's production structure according to the country's comparative advantages in a market economy with a facilitating state to ensure market competition and overcome hard and soft infrastructure bottlenecks for technological innovation and industrial upgrading so that the equity and efficiency can be achieved simultaneously in the primary distribution: 2) the state uses funds from tax revenues to carry out secondary distribution, with a strength determined by the country's value and ideological orientation, to further narrow the gap of income distribution arising from inequalities in inherited wealth, social networks and innate talents and use inheritance tax to reduce the intergenerational transmission of wealth gap; and 3) values of mutual cares are encouraged and tax incentives are provided to encourage philanthropic donations to help the under privileged and support other social goods such as research and innovation as a means for the tertiary distribution.

The source of income for the poor is primarily the wage earnings from their labor employment while the rich have a large share of income from capital earnings. The first principle will lead to efficiency and rapid growth in a country, which is elaborated in my response to Question III. The rapid growth will narrow the country's income gap with advanced countries, contributing to the equity across countries. More importantly the principle will also result in equity within the country because not only largest possible amount of jobs will be generated so the poor will have more opportunities to be employed than otherwise but also capital will be accumulated fast, causing relative prices of labor to capital to rise rapidly in favor of the poor wage earners over the rich capital owners (Lin and Liu 2008; Kuo, Fei, Ranis 1979). In addition, in such an economy, the enterprises will be viable in open, competitive market and the state does not oblige to give them protection and subsidies (Lin and Tang 1999). Therefore, the state will have more resources for secondary distribution than otherwise from both the tax revenues of dynamic economic growth and no needs of subsidizing nonviable enterprises. The income distribution will be further improved if the state uses its available resources to incentivize and facilitate entrepreneurs' technological innovation and industrial upgrading according to the change in comparative advantages so as to generate more higher-income jobs, to invest in the poor's human capital to make them employable in higher-skill works and to provide direct transfer through social benefits for the under privileged to mitigate the adverse distributional effects of personal endowments in wealth and talents. The third principle is also desirable in the modern world. Due to rapid technological innovations and structural transformation, some technology and business geniuses will become super rich quickly. Tax incentives should be provided to encourage philanthropic donations, which should also receive social recognitions, for their own self-satisfaction and for social harmony and a better society.

Due to the differences in the endowment structure and cultural heritage for countries at different levels of development, their economic systems will be different in many aspects. Moreover, due to the fact that an institutional service can be provided by different institutional arrangements and institutional change proceeds in a path-dependence manner, for countries at a similar level of development their economic systems are also likely to have many different institutional features. So just like no two apples look exactly the same, the economic system in each country will be somewhat different. The system plurality in the world, just like biodiversity, should be appreciated. No matter with what economic systems, people in all nation in the world share the same dream of growth with equity. Hope the humanity's internal drive for betterment and the competition among different economic systems will bring the impetus for institutional reforms and innovation to achieve growth with equity and the study of Comparative Economic Systems will enhance our understanding about how an economic system functions and contribute to the ideas, policies and institutional reforms for realizing the dream in every country in the world.

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