Market, Shmarket, WTO

by Michael S. Bernstam and Alvin Rabushka

In 2002, Western governments unleashed an inconceivable attack on the idea of the market economy. The U.S. and the European Union designated the worst performing countries in the world, still in the depth of the greatest peace-time contraction in history, as market economies. These are Russia and Kazakhstan, with Ukraine's recognition as a market economy pending. Simultaneously, the best performing economy in the world and in all of history, China, was explicitly and repeatedly denied the status of market economy. Vietnam, another of the best performing economies in the world, is similarly denied this recognition.

Figures 2.1 and 2.2 in Chapter 2 of our book *From Predation to Prosperity* documents the performance of these countries in the 1990s. The contrast between spectacular growth and precipitous decline is self-evident. The subsequent partial recovery in Russia in 1999-2001 did not even remotely compensate for the depth of the Great Contraction. We documented these dynamics in the article "New Data Confirms the Basic Relationships in the Russian Economy: Ten Years of the New Economic System Revisited." Meanwhile, China continues to grow at more than 8 percent per annum with no deceleration in sight.

The irony of the recent pronouncements is that Western governments themselves think differently when it comes to business and the real world. In December 2001, they admitted China into the World Trade Organization (WTO). In October 2002, after eight years of wrangling, Western governments have given up on Russia joining the WTO, and Russia itself recognized that it does not fit in. Russia now considers the appropriate time to join will be 2023 or 2030. Western governments are relieved.

This is a reality check. Furthermore, this is a rare, real-life test of the validity of modern thinking about the market economy and socialism. Of some 210 countries in the world, 144 are now members of the WTO. These are Western market economies, newly industrialized economies, emerging market economies, and even relatively low-income, developing economies which are fit to do business on the world market on equal terms among all. In this sense, the WTO is more than the World Trade Organization: It is the assembly of the world market economy, the framework of the global market.

There are only three consistent groups of countries which do not belong to this framework and thus do not qualify to join the WTO.

1. The poorest, least developed economies of Africa, the Middle East, and other parts of the Third World. For the lack of a better term, we characterized them as "political state socialism" in Chapter 5 of *From Predation to Prosperity*. One of their systemic features is called in the literature the "price scissors" between urban and rural sectors, or, more generally, between the primary sector (commodities) and the secondary sector (manufacturing). This subsidy of inefficient manufacturing suppresses output in the primary sectors, promotes industrial import substitution, and keeps afloat value-subtracting activities. The difference between Africa and Russia in this socialist redistribution is that the source of subsidy in Africa is agriculture while in Russia it is oil, gas, and

other natural resources. Russia resembles some Middle Eastern countries in this respect. The difference between Russia and Middle Eastern resource-rich economies is that the government conducts socialist redistribution of income in the latter while the enterprise network dominates the former and makes the government a symbiont. This is the difference between state and non-state socialism.

2. The last bastions of central planning, such as North Korea and Cuba.

3. Enterprise Network Socialism in Russia, Ukraine, Kazakhstan, and similar post-Communist economies. We dissected this new economic system in Chapter 1 of *From Predation to Prosperity* and discussed it in the context of 42 post-Communist countries in Chapter 2.[1]

Membership in the WTO is the best possible test of being part of the market world. China fits, Russia does not.

Cognitive dissonance

This is more than the tale of two countries. This is more than the tale of two misidentified economic systems. This is a tale of cognitive dissonance of Western governments and, more generally, of international economic policy. The following two contrasting batches of headlines and quotations highlight this case of cognitive dissonance.

Batch 1:

"European Union recognizes Russia as market economy." (AFP, November 7, 2002).

"Countries still considered as having non-market economies are China, Vietnam, and many of the former Soviet bloc nations except Kazakhstan, which was recently granted market economy status." (Ibid.)

"From now on, Russia will be treated on an equal footing with all other market economies." (AFX, November 7, 2002).

"U.S. decides to recognize Russia as a market economy." (*The New York Times*, June 7, 2002).

"U.S. accepts Russia as a market economy." (*Financial Times*, June 7, 2002).

"The decision could also help Moscow in its efforts to accede to the WTO. In U.S. talks with China,

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[1] Chapter 2 of *From Predation to Prosperity* was recently expanded and updated. We invite the reader to revisit it to review the new discussion of the origins and evolution of Enterprise Network Socialism after the abolition of central planning. This chapter also expands the discussion of the multi-dimensional perspective on economic systems. It lays out the income dimension, the government dimension, the property dimension, and the externalities dimension, and introduces exact definitions of private income and common income.

which recently joined the WTO, the U.S. insisted that China not be given full recognition as a market economy." (Ibid.)

"The U.S. earlier this year recognized Kazakhstan as a market economy and is also considering a request to give Ukraine the same treatment." (Ibid.)

Batch 2:

"Enter the Dragon." (*Financial Times*, December 10, 2001).

"China, one of the world's largest and fastest-growing economies, became the 143rd member of the World Trade Organization today." (*The New York Times*, December 11, 2001).

"China joins the World Trade Organization today amid signs of foreign investment bonanza in a country blessed with vast market potential." (*Financial Times*, December 11, 2001).

"Foreign investment would grow by 16 percent annually from 2002 to 2006, reaching $100 billion in 2006." (Ibid).

"China's emergence as the workshop of the world (...) This year China is expected to overtake the U.S. as the world's leading destination for foreign direct investment. Officials in Bejing predict a record $55 billion in investment inflows." (*Financial Times*, October 28, 2002).

"Lee Kuan Yew, Singapore's senior minister, sees China replicating Taiwan's success but on 50 times the scale. In South Korea, Jin Nyum, the deputy prime minister, has likened China to a black hole sucking in manufacturing capacity because it is capable of producing everything." (Ibid.)

"China's ascent up the technology ladder has been rapid. Chinese companies now make mobile telephony base stations, routers and sophisticated Internet equipment (...) Many of the world's top technology companies. Lured by the abundance of talent graduating from Chinese universities, have established R&D centers that undertake cutting-edge research." (Ibid.)

"Russia's bid for quick entry to the World Trade Organization is in jeopardy over its refusal to open its key sectors to foreigners, European Union trade negotiators said." (*The Wall Street Journal*, October 18, 2002).

"Moscow's enthusiasm for the WTO has waned in recent months (...) EU and American officials say Russia so far has failed to pass laws necessary to bring its trade regime in compliance with WTO rules and insists on tough curbs on foreign investment." (Ibid).

"After China signed up last year, Russia, which first applied for WTO membership in 1994, became the last big country left out of the trading club (...) 'Russia will join the WTO only on conditions that are beneficial to it,' said Russia's chief trade negotiator. 'This might be in 2003 or 2030." (Ibid.)

"Talks on Russia's entry into WTO hit snag. Russia has hit an impasse in talks with major trading partners about joining the group. (...) 'If we consider that the losses from joining outweigh the benefits, we will never join,' said Russia's chief negotiator." (*The New York Times*, October 18, 2002).

"For nations that mainly export manufactured products, like the United States and China, the benefits are obvious. For Russia, which mainly exports commodities like oil and gas, they are less so." (Ibid.)

To sum it up,

- Russia is a technologically backward country which qualifies as a market economy but does not qualify to join the WTO and has no use for it;

- China is a technologically advanced country which qualifies as a member of the WTO but does not qualify as a market economy.

Both are the learned judgments of Western governments.

Market economy vs. socialism

How can one account for this cognitive dissonance? Chapter 2 of our book *From Predation to Prosperity* offers a reconciliation.

First, China is a market economy which can readily function as a member of the WTO, while Russia is not and can not. Russia has a limited, indeed symbiont government and mostly private property. It redistributes around 80 percent of GDP through the private enterprise network. China runs a restrictive government with economic controls and marginal private property. But its new entrant-sector does not redistribute income and constitutes a market economy par excellence. This market sector produces about 80 percent of GDP. Chapters 1 and 2 documented these facts. Non-state socialism in Russia and a predominant market economy with restrictive government in China are the hallmarks of post-Communist experience.

Second, the scientific definition of the market economy does not exist, and mistaken identities by Western governments rest on the wrong criteria. They do not measure the extent of the market economy itself, for the lack of such measurement. Rather, they measure the extent of government restriction and control in the economy and assume the market economy as a residual. By this measure, Enterprise Network Socialism in Russia, private slavery in the Antebellum South, piracy in the high sea, and many other species of private predation automatically qualify as the market economy. Restrictive government becomes synonymous with socialism, limited government becomes synonymous with the market economy. By this residual view of the world, Russia is a market economy and China is not.

The false dichotomy of market vs. government, which we analyzed and criticized in Chapter 2, creates a one-dimensional perspective of the world. This linear perspective does not correspond to the rich reality of contemporary and historical economies. Chapters 2, 3, and 5 offer a multi-dimensional perspective instead. The reader can take a quick look at figures 2.3, 2.4, and 5.1 which introduce this perspective. It separates socialism from restrictive government and the market economy from limited government. More generally, it separates the government dimension from the income dimension. It is the income dimension and the dichotomy of private vs. common income which is relevant for defining the market economy and for measuring which country is a market economy and which country is a socialist economy. Private income—income exclusive to its earners and not redistributed to non-earners—defines the market economy. Common income, which is redistributed from earners to non-earners by predatory government or by predatory networks and other private predators, defines socialism. Chapter 2 offers exact and detailed definitions and simple, approximate measurements. By these measurements, applied in figure 2.1 and extended to the map of the world in figure 2.4, China is a market economy and Russia is a socialist economy.

The one-dimensional judgement of Western governments, which views the market economy as a residual of government control, finds the opposite. But the practical judgment of the same Western governments and the global business community at large sets the matters straight. This is why China is inside the WTO, along with real market economies, and Russia is the odd man out. The global business community effectively acts on the principles of the new, multi-dimensional paradigm. For global industrialists and investors, there is no cognitive dissonance. They know the market economy when they see one. And they know socialism for what it's worth.