The Impact of Transition to the Market Economy on Welfare Changes: Lessons from the Experience of Asian Transitional Economies*

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Introduction

Market transitions in the former Soviet Union and the Central and East European countries (the CEECs) have witnessed large-scale and widespread deterioration in social conditions (UNICEF, 1993, 1994, 1995; Milanovic, 1996). The worsening in social development indicators has been commonly viewed as an inevitable consequence of the severe economic decline as the concurrence of the two processes seems to have provided strong support for this simple causality. Social policies matter as well, but, compared with the severe impact of the economic decline, the role played by social policies is considered derivative from or of secondary importance to the determination of the welfare changes.

In light of the above conventional wisdom, this paper aims to explore the relationship between the economic changes and the social changes during a given transition period through an examination of the experiences of the Asian Transitional Economies (the ATEs). By Asian transitional economies I mean those Asian countries in which a centrally planned system was reformed through the introduction of market mechanisms at various times (mostly since the late-1970s). These countries include China, Mongolia, Vietnam, and the central Asian republics of Kazakhstan, Kyrgyzstan, Uzbekistan, and Turkmenistan (henceforth, the CARs).

One central question is: if economic recession has indeed led to the deterioration in social conditions in the CEECs, is it the case that the economic growth in the ATEs has been automatically followed by rising living standards and improved human development, and if not, why not?

I. Economic Transition and Welfare Performance

The onset of the economic transition in the ATEs varied from country to country, as did the first initiatives in their new economic course. China was the pacesetter, undertaking economic reform in 1978. Vietnam, after a few years of spontaneous“fence-breaking” and the relaxation of central control over the economy, began official reform programs in 1986. The CARs and Mongolia, more than a
decade after China's first reforms, received strong external shocks that were largely responsible for opening the way to a more radical economic transition in 1991. The sweeping changes in and the ultimate collapse of the Soviet Union left these countries no alternative but to modify immediately the economic and political structures so closely associated with the Soviet system.

1. Economic growth
The ATEs took diverse approaches towards reform, ranging from the so-called “gradualism” or “Incrementalism” of China to the drastic “revolution” in countries such as Mongolia economic transition was not, however, merely a matter of economic change: in the CARs and Mongolia, in particular, because of the sudden external shocks generated by the disintegration of the USSR, economic transition was obliged to proceed hand in hand with nation building. The ATEs, on the other hand, have managed to maintain political stability while pursuing reform. In all of the ATEs, the socio-political situation has been crucial in the formulation of transition strategies and in limiting the policy options available to the respective governments. With regard to economic performance, a marked difference exists between the ATEs on the one hand and the CARs and Mongolia on the other.

Table 1. Estimates of Real GDP Growth Rate, 1985—1995, and Per Capita GNP

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>China</td>
<td>9.6</td>
<td>13.5</td>
<td>11.8</td>
<td>10.2</td>
<td>530</td>
</tr>
<tr>
<td>Vietnam</td>
<td>4.9</td>
<td>8.1</td>
<td>8.8</td>
<td>9.5</td>
<td>190</td>
</tr>
<tr>
<td>Mongolia</td>
<td>0.8</td>
<td>-3.0</td>
<td>2.3</td>
<td>6.3</td>
<td>340</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>-14.9</td>
<td>-12.9</td>
<td>-25.4</td>
<td>-8.9</td>
<td>1,100</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>-15.9</td>
<td>-15.6</td>
<td>-26.5</td>
<td>-6.2</td>
<td>610</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>-6.1</td>
<td>-2.3</td>
<td>-3.4</td>
<td>-2.7</td>
<td>950</td>
</tr>
</tbody>
</table>


The East Asian pattern of economic performance involves a combination of transformation and growth, China and Vietnam having witnessed an acceleration of economic growth since the early years of reform. In the near two decades since its first reforms, China registered a tremendous 9 percent annual growth rate, while Vietnam, after a slower start, registered a GDP growth rate of 8—9 percent in the first half of the 1990s.

On the other hand, in the CARs and, to a somewhat lesser extent, Mongolia, radical transition measures have led to severe economic contraction with a substantial erosion in GDP and standards of living. The extent of this economic decline has varied: the output drop in the CARs has been generally milder than that in the former USSR as a whole, and it has been less dramatic in Uzbekistan and Mongolia than in Kyrgyzstan and Turkmenistan. In particular, in 1992, as inter-republic trade in the former Soviet
Union diminished, output began to fall more rapidly in all of the newly independent CARs (Pomfret, 1996).

The GDP changes have made a significant difference in the material lives of people. In both China and Vietnam exhibiting positive economic growth, the average income has risen, the quality of life has improved, and poverty has been reduced substantially. In contrast, because of the economic decline, per capita income in the CARs and Mongolia has decreased, and this negative effect shows itself in the changes in diet profile: expenditures on bakery goods and vegetables has remained stable, but the consumption of meat and especially dairy products has fallen. (Pomfret 1995).

2. Income distribution
In terms of economic performance, the experiences of China and Vietnam constitute what has come to be called the “Asian model,” whereas the experiences of the CARs and Mongolia appear to fit more closely with the “East European model.” However, the welfare changes in these countries do not appear to reflect entirely these patterns of economic performance.

Despite the disparity in economic performances, the ATEs have shared at least one common feature during the transition, namely an increasing inequality in income distribution. In this respect, positive or negative economic performance does not seem to matter; instead, the differences between them apparently manifest themselves mainly in terms of the degree and speed of the growth in income inequality. On the eve of the reforms in China by the end of the 1970s, one characteristic of its income distribution was the coexistence of a wide income gap between urban and rural areas but with a highly egalitarian income distribution within each area. Largely due to the conspicuous rural-urban income gap, the overall Gini Coefficient in China was higher than that in other centrally planned economies of the former Soviet Union and Eastern Europe, although it was lower than that in developing market economies.

The economic reforms have brought noticeable changes in China: income inequality is on the rise along with economic growth. Whereas in the past the inequality was largely produced by differences between rural and urban areas, it is now being driven by a widening gulf between the rich and the poor, a marked divide between coastal and inland regions, and an even more obvious chasm in living standards between rural and urban populations (Griffin and Zhao, 1993; Zhang, 1997).

As for Vietnam, due to problems with official data and the lack of alternative information sources, it is difficult to assess income inequality accurately. However, studies have generally agreed that, amid the substantial improvement in overall standards of living, income gaps since the reforms have been widening.

In the ATEs that have experienced economic recession, economic decline has led to a substantial deterioration in the living standards of large portions of the respective
populations and has shattered for everyone the sense of income safety. Income inequality has worsened, and a group of newly rich and newly impoverished has emerged.

Studies have found that the distribution of income in the CARs became more unequal after the collapse of the centrally planned system in 1991. According to a World Bank estimate, the Gini Coefficient increased from 9.33 in 1987—1988 to about 50 in 1993 in the Kyrgyzstan (World Bank, 1996: 69). Even when the economic situation in some CARs began to improve in the mid-1990s, income inequality continued to rise (Interfax, 1996: 29).

The fact that income inequality increases following economic transition regardless of economic performance is well recognized: it has been the case in the CEECs as well (World Bank, 1996: 68—70). Rising inequality is frequently attributed to such factors as wage liberalization, boosts in the incomes earned in the private sector, and mounting individual wealth.

The experiences of the ATEs suggest that rising income inequality has little to do with macroeconomic performance. The drastic growth in income inequality has transformed some of the transitional economies from relatively egalitarian societies into highly polarized societies. This has posed a difficult problem for the governments of all the ATEs that have been struggling, on the one hand, to maintain social stability (which may be threatened by the rising inequality), and, on the other hand, to pursue market reforms (which continue to polarize incomes). A number of governments in the ATEs continue to link their legitimacy to socialism, in which equality is a core concept. In the case of China, “common prosperity” has been the slogan of those reforms under which the government has been mobilizing mass support. The reality that continuous economic growth leads to a continuously widening income gap—raises doubts as to the extent to which income disparities can be encouraged in the name of efficiency and/or to the extent to which development can be sustained without causing social discontent thereby undermining the reform consensus.

3. Poverty

It is well established that poverty takes many forms and is determined not only by low per capita income, but is also characterized by “inadequate access to and control over basic social and economic resources and opportunities that can develop human capabilities necessary to participate in and contribute to society” (UNDP, 1996: 3). To eradicate poverty is to establish the provision of the basic needs for all. With respect to material provisions, the elimination of poverty necessarily entails the eradication of hunger and malnutrition through the establishment of food security, a universal access to education, employment, and health care services. To alleviate poverty requires not only economic growth, but also a wide participation by the population in the benefits of this growth.
The ATEs have had a range of experiences with poverty during their transitions. The negative growth which occurred in the CARs and Mongolia has contributed to a rise in the incidence of poverty. As output has shrunk, general income levels have dropped, and those at the low end of the income scale have slipped into poverty. Moreover, as might have been expected, because of the decline in state revenues following economic contraction, governments have faced greater pressure to cut public spending for social provisions, which previously helped those people most in need. The sudden, widespread, but relatively shallow poverty emerging in transitional economies has been labeled as “transitional poverty.”

In China and Vietnam, where growth has been rapid and broadly based, poverty has declined substantially. These countries managed to reduce poverty at the very beginning of the reforms and throughout the early years of reform. However, the progress of poverty reduction has not been linear. During the initial phase of rural reforms in China, 200 million people were lifted out of poverty. After the mid-1980s, as reforms began to move further towards a market orientation and touched off the restructuring of the entire economy, the number of the poor stopped declining, even though economic growth was being maintained. According to the World Bank (1996: 69), the share of the population living below the poverty line fell by 24 percent during 1978—1985 and then rose by 1 percent during 1985—1993.

One characteristic of poverty in the ATEs is that it is generally "shallow," by which is meant that people move back and forth into and out of poverty. The members of large or single-parent families, the unemployed, those lacking education, the elderly, and those without access to assets (for instance, access to land in Armenia and Ukraine) are most likely to be poor in the CEECs (World Bank, 1996: 71).

Economic performance has proved to be the most crucial factor in the elimination of poverty. The achievements in poverty reduction in countries where economic growth is strong (China and Vietnam) are remarkable, whereas in the ATEs facing economic recession poverty has been on the rise. Nonetheless, experience also suggests that economic growth alone is not sufficient to ensure a continuous decline in poverty.

4. Employment

Prior to the reforms in the ATEs, full employment and life-long job security were the key elements in the social safety nets. However, the term “full employment” in the centrally planned systems of Asia cannot be taken at face value, as it was accompanied by such problems as the under-utilization of the labor force, and/or job shortages, low labor force efficiency, and the lack of labor mobility. In the case of China and Vietnam, for example, full employment did not mean that welfare conditions were the same in rural and urban areas. As a general rule, the work-related benefits falling to rural populations remained inferior to those available in the state sector or in larger towns and cities.
In the CARs and Mongolia, unemployment mounted steadily during the early years of the transition (OECD, 1994, 1996; Interfax, 1995). The serious economic recession has usually been blamed for this trend. When there is a sharp decline in output, job opportunities shrink. It was thus anticipated that, when the economic situation improved, job opportunities would re-appear, thereby easing the pressure of unemployment.

However, this has not occurred. In Kyrgyzstan in 1995, for example, although the declining trend in the GDP that had been evident between 1992 and 1994 was significantly slowed, the labor market did not rebound accordingly, and unemployment continued to rise (Interfax, 1995: 22).

Despite its record-breaking economic growth, China has also been facing mounting pressure from unemployment. In Vietnam, as in China, dynamic economic growth has not prevented a rise in unemployment: urban unemployment in early 1995 was estimated at over two million, and the unemployment rate was as high as 25 per cent in some urban areas (ADB, 1996: 28).

Although growing unemployment is a universal phenomenon in the ATEs, economic performance and the nature of reform policies are playing an important role in the speed, scale, and character of the unemployment in each country.

Changing patterns in employment and unemployment in the ATEs have been brought about by the restructuring of state-owned enterprises, by the dynamics of the non-state sector, and by greater labor mobility. As the transition continues, transitional unemployment is unlikely to vanish. As labor markets adjust to the emerging economic structures, unemployment benefits and social security programs will have to be and are being modified.

5. Human development
Education, health, and long life are essential if people are to be able to participate fully and meaningfully in the economy and society. In this sense, the initial outcomes of the reform process in the ATEs have been mixed at best.

Reforms in the ATEs have necessitated changes in the institutional framework of welfare provision as pre-reform institutions have collapsed or been restructured; responsibility for the management of welfare provision has been shifted to emerging market-oriented institutions, while users are being required to cover the service costs. Thus, as universities have begun to charge tuition, and hospitals and expensive private service providers such as kindergartens have started to institute fees or demand greater fees, higher quality education and health care facilities are increasingly becoming available only to those who can afford them.
The initial assessment is not entirely positive. In China the achievements in human development appear to be far from matching the advances in economic performance. Although health status (as measured by indicators such as life expectancy at birth and maternal mortality) continues to improve, one must bear in mind—even while observing these improvements—that a number of these indicators measure long-term cumulative trends, which may not be subject to reverses even by rather dramatic economic or social changes over the short term. (Preston, 1975: Rodgers, 1979: Murray and Chen, 1992).

The experience in Vietnam has been similar to that in China. Before the reforms, Vietnam established a universal educational framework despite the country's poverty: about 4 percent of the state budget went to education. Generous material and organizational investment in education resulted in high literacy and student enrolment rates, and, indeed, the record of education in Vietnam surpassed that in China. In addition, the health status of the population was improved significantly (Fforde and de Vylde, 1996: 234). This latter achievement can to a large extent be attributed to the existence of a nationwide primary health care network, which linked communal health care centres.

In both China and Vietnam there have been worrying signs of deterioration in certain aspects of social development. The dismantling of the collective social security system has affected a large swath of the population, especially the vulnerable. User fees have become common at health care centers. Primary schools have come to depend on the availability of local resources and the initiative of local authorities and communities. It is not uncommon that relatively more girls were dropping out of school, because families, now forced to pay for education, were tending to save money by favoring education among male offspring. Difficulties have occurred in the maintenance of primary health care services as well, especially in rural areas, largely because of the shortage of public financing.

Table 2. Social Indicators for Selected ATEs

<table>
<thead>
<tr>
<th>Country</th>
<th>Life expectancy</th>
<th>Infant mortality rate (per 1,000)</th>
<th>Maternal mortality rate (per 100,000)</th>
<th>Adult literacy rate(%)</th>
<th>Gross primary enrolment (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>Female</td>
<td>Male</td>
<td>Female</td>
<td>Male</td>
<td>Female</td>
</tr>
<tr>
<td>China</td>
<td>68</td>
<td>71</td>
<td>31</td>
<td>95</td>
<td>87</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>64</td>
<td>73</td>
<td>31</td>
<td>55</td>
<td>99</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>62</td>
<td>70</td>
<td>37</td>
<td>63</td>
<td>99</td>
</tr>
<tr>
<td>Lao PDR</td>
<td>50</td>
<td>53</td>
<td>97</td>
<td>300</td>
<td>65</td>
</tr>
<tr>
<td>Mongolia</td>
<td>62</td>
<td>65</td>
<td>60</td>
<td>240</td>
<td>98</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>72</td>
<td>37</td>
<td>34</td>
<td>98</td>
<td>96</td>
</tr>
<tr>
<td>Vietnam</td>
<td>65</td>
<td>69</td>
<td>36</td>
<td>120</td>
<td>92</td>
</tr>
</tbody>
</table>

Compared to China and Vietnam, the CARs and Mongolia enjoyed more extensive state-financed welfare systems during the socialist period. However, this high level of state support rendered the systems more vulnerable to sudden economic changes. In the worsening macroeconomic situation and the financial crisis linked to the transition, social programs have usually been among the first casualties of budget cuts. By the mid-1990s, many indicators of human development in the CARs and Mongolia were no longer more favorable than those in China and Vietnam, although the latter had much lower per capita incomes.

6. Summary
The ATEs in transition have witnessed a mixed package of welfare outcomes. To be sure, economic growth or the lack of it has been a decisive factor in the changes in such basic welfare conditions as per capita income, nutrition, and level of poverty. In China and Vietnam, rapid economic growth has resulted in higher household incomes, greater access to consumer goods, improvements in diets, and rising living standards, as well as sharp reductions in poverty. The achievements in poverty alleviation are indeed remarkable, underlining the fact that reform-induced growth has benefited the most disadvantaged in the population. In those countries that have suffered through economic recession, little hope of such improvement has been available to the majority, and poverty has increased. However, economic performance has not represented a clear dividing line between those countries that have gained from the transition and those that have lost. Other social indicators (life expectancy at birth, school enrolment rates, and health conditions) are showing trends that do not depend only on economic growth. Furthermore, in terms of social cohesion, relative economic performance appears to be even less relevant, since in this respect there seems to have been deterioration everywhere in the ATEs. The Asian transition shows once again that economic growth alone is insufficient to produce human betterment in all its facets.

II. The Roles of Social Policies and Institutions

The social policies implemented during the transitions in the ATEs as outlined above, have, in a broad sense, been adopted to overcome problems inherited from the socialist welfare systems, and to accommodate emerging market-oriented economic structures. Governments in economic recession have often been forced to undertake temporary measures to deal with the urgent pressure of shrinking resources. As an integral component of the general reform agenda, social policies during the transition have shown a common tendency to facilitate the role of the market in resource allocation in both the economic sector and the social sector. Hence, irrespective of economic performance, the ATEs have moved in a similar direction in reforming existing welfare systems.
In all of the ATEs, policy makers have made great efforts to evaluate and adjust the provision of services in education, health care, and social welfare. The role of the public and private sectors in supplying these services has been constantly redefined with respect to organizational structure and financing mechanisms. Various cost recovery schemes and methods to encourage the participation of the non-state sector in social services and social insurance have been tried. As this is an on-going process, the slowly evolving market structures have been intermingled with the old welfare systems. The speed and the extent of the modification of these old welfare systems have varied widely. In general, the success or failure of government policies can be measured only on the basis of the end results; that is, by human development indicators (provided that the time lapse between policy implementation and outcomes is taken into consideration).

In the pre-transition ATEs, although the orientation of social policy was similar, the basic welfare systems were quite diverse, ranging from the Soviet-type welfare states of the CARs and Mongolia, to dual or “split” welfare provision involving separate rural and urban systems in China and Vietnam. In all these countries, reforms have been implemented in every area of social service and provision, including retirement, unemployment, housing, education, health care, and social assistance for the most vulnerable groups.

One tendency has been a retreat of the state from welfare obligations. Governments everywhere are reducing their role in the administration and coordination not only of the economy, but also of social welfare and protection measures. The character and speed of this retreat are being affected by the overall approach to transition. The most significant retreat seems to have taken place where the reform approach has been most radical.

In the provision of social services, one common step has involved adjustments in the budget allocations to education and health care. The governments of the CARs and Mongolia have been financially squeezed because of economic recession, but also because, following the collapse of the Soviet Union, outside assistance dried up. In China and Vietnam, while there has been strong economic growth, budget expenditure in specific areas of social provision has sometimes either stagnated, or been reduced as a proportion of GNP.

Insufficient state funds have created difficulties in the maintenance and improvement of health care and educational facilities, and this has contributed to the collapse of services in some places and to a decline in service quality in others. Service providers from the non-state sector have occasionally emerged, but usually they have been too limited in number and in coverage to replace state services, and they have often been too expensive for ordinary citizens. In response to the financial difficulties, public-sector schools and health care institutions have begun to charge fees, as mentioned above.
Another common tendency in the ATEs is that social policies are frequently out of step with economic and institutional changes, and this tends to create additional hardships for the populations. In China and Vietnam, the collapse of the rural collective system and the social safety nets occurred long before alternative mechanisms for welfare provision were identified.

In contrast, there has been no sudden and thorough destruction of welfare institutions in the CARs or Mongolia or in the urban sector in China and Vietnam, largely because of the fear of the social unrest that could arise due to these losses. The gradual and rather prudent approach to reform in social welfare systems has undoubtedly helped prevent further deterioration in human well-being in the face of the drastic socioeconomic changes.

In China and Vietnam, the huge gap between urban and rural welfare systems needs to be bridged. In the countryside, because of the disappearance of collective social safety nets, rural populations have become entirely dependent on the extended family for old age support and poverty relief. However, the family welfare function has its limits and is becoming inadequate as the trend towards smaller families and greater labor mobility continues. Meanwhile, urban welfare systems are still highly fragmented. The lack of universal coverage means that the government must formulate policies and regulations to create broad-based social welfare systems and safety nets.

In the CARs and Mongolia, where welfare systems attained universal coverage long before the transition, the problem is how to maintain social provisions while making adjustments consistent with the new role of the market as a dominant mechanism for resource allocation. Faced with economic difficulties, governments have cut social expenditures so as to bring budgets under control and achieve macroeconomic stability. For instance, Kazakhstan eliminated the indexing of social benefits to cost-of-living increases and tightened eligibility requirements in order to reduce the government fiscal deficit. However, while these measures have allowed the government to achieve some control over the budget, the process has left gaping holes in the social safety net (ADB, 1996: 28).

In general terms, it would be disastrous to a populations' well-being if social policies during the reform process were oriented simply towards the reduction of welfare provisions and social protection, instead of constructing systems that are more efficient and welfare-enhancing.

III. Conclusion: Balancing Well-being and Economic Transition
By now it ought to be clear that there are no quick-fixes. Anyone who still expects the market to solve all economic and social problems is likely to be disappointed. Dealing with current social problems will require the constant reassessment of policy priorities
and, perhaps more importantly, a rethinking of certain guiding principles behind the transitional and social development initiatives.

China and Vietnam have exhibited exceptionally good economic performance and per capita income has grown substantially, but even in those countries the welfare achievements have been neither even nor consistent. Erosion is evident in a number of human development indicators: unemployment is rising; social services are dwindling; people are losing their sense of security; and access to education and health care is becoming more limited. Because of the uneven economic and welfare gains, the gaps among social groups, among regions, and between urban and rural areas are widening. This is contributing to social tension. Although economic growth in China and Vietnam has been relatively broad-based and living standards have improved substantially, the problems remain stubborn, and their solution requires fuller participation by the entire population in the benefits of economic growth. The welfare gains have been considerable, but they are still not in line with the enormous resources released through the reforms. The imbalance between economic development and improvements in welfare is not accidental. Government reform strategies have been emphasizing economic growth while the promotion of social development has been far less vigorous. If economic recession is added to this mix (as it has in other ATEs), it should not be surprising if the welfare situation worsens.

In view of the welfare changes during the ATEs' transition, a new pattern of development seems to have emerged. Under the centrally planned system, the achievements in human development were greater than the level of economic development might indicate. Now, the focus has shifted, and human development has suffered. If the socialist regimes failed to produce the desired economic growth (as many have argued), the policy makers of reform ought not to repeat the mistake by simply shifting the ideology to free market doctrines. The market will not produce all the answers. Welfare gains must be maintained, and policy makers should abandon the idea that they can afford to wait because economic growth will automatically generate solutions to welfare problems.

As increasingly recognized in development theory, economic development has significance only if it leads to improvements in human welfare. This concept should be applied to the economic transition, which cannot be an end in itself. The success of the transition will be judged ultimately on the basis of the outcome in human development. The experiences of Asian transitional economies suggest a need to move away from a one-sided focus on economic growth to a people-oriented approach through the adoption of policies which place the well-being of the population at the center of transitional and development strategies.

References


