



COMPARATIVE ECONOMIC SYSTEMS

CULTURE, WEALTH, AND POWER
IN THE 21ST CENTURY

STEVEN ROSEFIELDE



ABOUT COMPARATIVE ECONOMIC SYSTEMS

“Now that the transition is over, Professor Steven Rosefelde is bringing back a new and improved version of comparative economic systems, one that treats culture, politics, and business misconduct explicitly in a market context. Rosefelde’s approach is original and sophisticated, producing a theoretically rigorous text still accessible to the advanced undergraduate student. Students will learn a large amount of economic theory and come to appreciate the variety of economic systems and the sources of that variety. This is a signal accomplishment by a serious scholar and student of comparative economics.”

James Millar, George Washington University

“This book is an outstanding text to acquaint students with the differences among the world’s major economic systems. Its author is one of the best-informed and most careful scholars in the field.”

Quinn Mills, Harvard Business School

“This is an ambitious and innovative work that rigorously and successfully addresses a question that economists often and mistakenly ignore: namely, how do ethics, culture, and politics affect the operation of core economic principles and the relative performance of the major economic systems in the global economy?”

Charles Wolf, RAND

“Rosefelde provides a forward-looking text that is firmly grounded in the fundamentals of comparative economics but that seizes fully the opportunities offered to the field by the end of the cold war. This is a text that can make comparative economic systems a “must-take” course for every undergraduate and a “must-offer” course for every economics department.”

Josef C. Brada, Arizona State University

To David, my cherished son.

Comparative Economic Systems

Culture, Wealth, and Power in the 21st Century

Steven Rosefielde

 **BLACKWELL**
Publishers

Copyright © Steven Rosefielde 2002

The right of Steven Rosefielde to be identified as author of this work has been asserted
in accordance with the Copyright, Designs and Patents Act 1988.

First published 2002

2 4 6 8 10 9 7 5 3 1

Blackwell Publishers Inc.
350 Main Street
Malden, Massachusetts 02148
USA

Blackwell Publishers Ltd
108 Cowley Road
Oxford OX4 1JF
UK

All rights reserved. Except for the quotation of short passages for the purposes of
criticism and review, no part of this publication may be reproduced, stored in a
retrieval system, or transmitted, in any form or by any means, electronic, mechanical,
photocopying, recording, or otherwise, without the prior permission of the publisher.

Except in the United States of America, this book is sold subject to the condition that it
shall not, by way of trade or otherwise, be lent, resold, hired out, or otherwise
circulated without the publisher's prior consent in any form of binding or cover other
than that in which it is published and without a similar condition including this
condition being imposed on the subsequent purchaser.

Library of Congress Cataloging-in-Publication Data

Rosefielde, Steven.

Comparative economic systems : culture, wealth, and power in the 21st century /
Steven Rosefielde.

p. cm.

Includes bibliographical references and index.

ISBN 0-631-22961-2 (alk. paper) — ISBN 0-631-22962-0 (pb. : alk. paper)

1. Comparative economics. I. Title.

HB90 .R665 2002

330—dc21

2001043234

British Library Cataloguing in Publication Data

A CIP catalogue record for this book is available from the British Library.

Typeset in 10/12 pt Baskerville
by Kolam Information Services Private Ltd, Pondicherry, India
Printed in Great Britain by TJ International, Padstow, Cornwall

This book is printed on acid-free paper.

CONTENTS

List of Figures	vii
List of Tables	ix
Acknowledgments	x
Preface	xii
Introduction	1
Part I Systems	5
1 Comparative Economic Systems	7
2 Classification and Principles	16
3 Culture, Politics, and Economic Misconduct	45
4 Power	54
Part II Perfect Economic Mechanisms	57
Introduction	58
5 Perfect Competition	62
6 Perfect Governance	69
Part III Great Powers	77
Introduction	78
7 America	81
8 Continental Europe	106
9 Japan	123
10 China	143

vi Contents

11	Russia	162
12	Transition	182
13	Comparative Potential	191
Part IV	Performance	197
14	Measurement	199
15	Global Performance	207
Part V	International Relations	235
16	Security	237
17	Military Balance	249
18	Interplay of Systems: Efficiency and Power	259
	Glossary	266
	Index	274

FIGURES

2.1	Consumer marginal utility function	21
2.2	Consumer demand function	22
2.3	Consumer assortment utility optimization	22
2.4	Labor supply function	25
2.5	Factor mix cost minimization	25
2.6	Profit-maximizing	25
2.7	Stages of factor productivity	26
2.8	Walrasian price adjustment	28
2.9	Marshallian production adjustment	28
2.10	Keynesian macroproduction possibilities	34
2.11	Business confidence and Keynesian aggregate investment	34
2.12	The classical market for loanable funds	36
2.13	The Keynesian market for idle cash balances	36
2.14	(a) Hicks–Hansen partial equilibrium in the idle cash balances market; (b) Hicks–Hansen partial equilibrium in the market for loanable funds; (c) nonfull employment and full employment GDP equilibria	38
2.15	The Fisherian general competitive interest rate and GDP equilibrium	39
5.1	Perfectly competitive general equilibrium	64
5.2	The perfectly competitive utility possibility frontier	67
6.1	A schematic representation of the transactions table of a static, open input–output model	72
7.1	The universal systems set	94
7.2	American factor allocation	95
7.3	American production possibilities	95
7.4	American efficiency possibilities	95
7.5	American consumption possibilities	99
7.6	American retail distribution	100
7.7	American utility possibilities	100
8.1	Continental European factor allocation	115
8.2	Continental European efficiency possibilities	116
8.3	Continental European retail distribution	116
9.1	Japanese factor allocation	131
9.2	Japanese efficiency possibilities	132
9.3	Japanese retail distribution	135

viii Figures

10.1	Chinese factor allocation	154
10.2	Chinese efficiency possibilities	154
10.3	Chinese retail distribution	155
10.4	Chinese utility possibilities	155
11.1	Russian factor allocation	174
11.2	Russian efficiency possibilities	175
11.3	Russian retail distribution	176
11.4	Russian utility possibilities	177
14.1	Soviet economic potential interpreted from the standpoint of index number relativity	205
15.1	(a) Three-world per capita GDP growth 1995–2025; (b) great power per capita GDP growth 1995–2025	216
15.2	(a) Distribution of global GDP; (b) distribution of great power GDP	217

TABLES

2.1	Economic systems: main concepts	18
7.1	Federal resources by function 1998	86
12.1	Real GDP/NMP in the ECE transition economies, 1980, 1986–99	188
12.2	Consumer prices in the ECE transition economies, 1990–99	190
14.1	Coefficients of factor productivity	203
15.1	Indicators of comparative systemic performance population, GDP, growth and inflation: Two-world and three-world models	208
15.2	Indicators of comparative systemic performance population, GDP, growth and inflation	210
15.3	Per capita GDP growth projections 1995–2025	213
15.4	GDP growth projections 1995–2025	214
15.5	Indicators of comparative systemic performance: macropolicy	219
15.6	Indicators of comparative economic structure	220
15.7	Indicators of comparative systemic performance: military activities	220
15.8	Indicators of comparative systemic performance: employment structure and labor conditions	221
15.9	Indicators of comparative systemic performance: poverty and inequality	222
A15.1	Eastern Europe and the Commonwealth of Independent States: per capita income 1995	224
A15.2	Europe: GDP, per capita income, and other selected indicators (1995)	225
A15.3	Europe: GDP per capita and growth	226
A15.4	Eastern Europe and the CIS: GDP per capita and growth	226
A15.5	GDP per capita and growth: selected cases from the Second and Third Worlds	228
16.1	Security systems: main concepts	239
17.1	Aggregate number of strategic delivery vehicles	251
17.2	Russian and US military equipment arsenals 1998	252
17.3	China's force structure: 1998 armed forces personnel (active)	253
17.4	Japan's force structure: 1998 armed forces personnel	254
17.5	Estimated production of major weapon systems, Russia 1990–97	254
17.6	Comparative size estimates of Russian and American defense activities	255
17.7	Department of Defense: total obligational authority	256

ACKNOWLEDGMENTS

The ideas in this text have evolved over decades, and my indebtedness to others is extensive. Abram Bergson, Paul Samuelson, Wassily Leontief, Evsey Domar, Oscar Lange, Kenneth Arrow, Jan Tinbergen, Ralph W. Pfouts, Janos Kornai, Gottfried von Haberler, and Alexander Gerschenkron shaped my thinking about the Newtonian core of economics, and the formal correspondences between generally competitive markets and optimal planning in all their capitalist and socialist guises. Their work led to the realization that if one began with Anglo-American premises about the sanctity of individual preferences, consumer sovereignty, competitiveness, fairness, and the rule of law, then there was a Pareto class of outcomes which appeared to validate the claim that modern micro- and macroeconomic theories were universal. Moreover, imperfect competition derived from the same premises did not contradict this universality; it merely extended the logic to the second best.

The collapse of the Soviet Union, the Yeltsin transition, and a decade of research in Japan were also formative because they compelled me to come to grips with economies that could not be adequately conceptualized with Anglo-American premises. Ruth Benedict's writings and the coaching of the eminent anthropologist Robert Levy showed me how cultures created alternative premises guiding economic activity, and Samuel Huntington's contention that power-seeking was the motor of international relations brought home the conceptual gulf between economic and political perceptions of utilitarian motivation. Their ideas forced me to appreciate that a truly universal theory of economics had to endogenize culture, power, and the sets of systems created when these influences were combined with the Newtonian core.

Sorting all this out has been difficult and I am grateful to all those who critiqued my false starts, and engaged me in fruitful dialogue. In particular, I wish to acknowledge the assistance of Ralph W. Pfouts, Dan Quinn Mills, Stefan Hedlund, Emil Ershov, Valarii Makarov, George Kleiner, Vyacheslav Danilin, Evgeny Gavrilentov, Alexander Bulatov, Aleksei Ponomarenko, Vladimir Ivanov, Leonid and Inna Lamm, Alyona Kirtsova, Yuri Avvakumov, Maasaki Kuboniwa, Yoshiaki Nishimura, Masumi Hakogi, Ken Morita, Yoji Koyama, Shinichiro Tabata, Sadayoshi Ohtsu, Haruki Niwa, Akira Uegaki, Tamotsu Nakano, Philippe Debroux, Kaoru Nakata, Jim Millar, Gur Ofer, Martin Spechler, Joseph Berliner, Gregory Grossman, Murray Feshbach, John Hardt, Alec Nove, Howard Stein, Edith Terry, Pekka Sutela, Jan Rylander, Andrew Marshall, Patrick Parker, William Van Cleave, William T. Lee, Igor Birman, Joseph Churba, Vitaly Shlykov, Alexander Belkin, Stephen Blank, Lennart Samuelson, Jan Leijonhielm, Bengt-Goren Bergstrand, Wilhelm Unge, and David Rosefelde.

Special thanks goes to Stanislav Gomulka, Stefan Hedlund, and Quinn Mills for their critical comments on the final draft.

Although this text was not directly supported, it could not have been written without the financial assistance or cooperation of many institutions over the years, including the Carnegie Foundation of New York, the Institute for Arts and Humanities (UNC), The Japanese Ministry of Foreign Affairs and Monbusho, the National Research Council, The Peace Institute and Institute for Communist Societies in Transition (Australian National University), the Social Science Research Council, Japan Society for the Promotion of Science, the Erhardt Foundation, IREX, the Abe Foundation, the Japan Foundation, Institute of Economic Research (Hitotsubashi University), Hiroshima University, Ryukoku University, ERINA (Niigata), Fulbright Fellowship, Central European University, National Science Foundation, Hoover Institution, ACLS, the Ford Foundation, Office of the Secretary of Defense, the CIA, DIA, United States Naval Postgraduate School, the Center for Defense and Strategic Studies, FOI (Swedish Defense Establishment), Stockholm Institute of East European Economies, Center for Defense and Strategic Studies (Southwest Missouri State University), and the Council on Foreign and Defense Policy (Moscow).

Nancy Kocher tirelessly and cheerfully prepared seemingly endless drafts of the manuscript.

My wife Susan and daughter Justine gave me support and encouragement, and my brother Alan insights into the strengths and weakness of the American system of commercial and tax law.

To all, I express my deep gratitude.

Steven Rosefelde

PREFACE

The 21st century poses serious challenges to the discipline of comparative economic systems. Until the collapse of Soviet communism on December 25, 1991, comparative economics was primarily concerned with describing the principles of markets and state planning, and assessing the relative merits of capitalism and socialism. During the ensuing years attention shifted toward “transition”; that is, the anticipated transformation of the former communist states from authoritarian command economies to democratic market free enterprise. Comparative economics was perceived as a field headed for extinction, concerned primarily with documenting the final triumph of American capitalism, as “liberalization” swept the globe and managed economies vanished.

The Asian crisis, which began in the summer of 1997 and quickly spread throughout Eurasia and Latin America, provided a useful reminder that post-Soviet optimism should not be overdone. Russia’s and China’s futures remain precarious, Europe clings to democratic socialism, global economic growth is anemic, and the world is periodically faced with international economic destabilization. Once again there is a need to understand not only the principles which bind the economies of the world together, but those which divide them.

Since most nations today rely heavily on markets, the task of discriminating critical features of economic systems has proven illusive. The old established principles of monopoly, oligopoly, and imperfect competition provide some clues, as do concepts like stages of economic development, but they do not explain why systems like Russia and China perform so differently. This text attempts to fill the gap by explaining how culture in various guises modifies the standard rules of economic engagement, creating systems with properties that differ markedly from those predicted by the theory of general market competition. The analysis is grounded in established principles, but also assumes that individual utility-seeking may be culturally determined; that political goals may take precedence over public well-being, and that business misconduct may be socially detrimental.

These possibilities are not denied by other theorists. Everyone knows that inefficiency, oligopoly, obligation, misgovernance, moral turpitude, and criminality may diminish economic performance, and that positive cultural attitudes toward work and community could be beneficial, but these factors are usually treated as peripheral to the basic laws of supply, demand and their equilibration. The new approach avoids this prejudgment by reformulating the micro- and macroeconomic laws of demand, supply, and equilibration to incorporate culture, politics, ethics, and institutional factors in perfect markets, inefficient markets, anticompetitive markets, obligatory transactions, and state administration. As in

the old approach, people are motivated by utility-seeking, but they do not always abide by the rules of free individualist competition. Their actions are modified by social ideals like collectivism and communalism, as well as by compulsion.

Coverage is restricted to highlight how culturally motivated rules of market engagement illuminate the performance possibilities of modern economies, with special attention paid to the great powers, and the widening gap between the rich and poor. Issues of historical interest are touched upon where appropriate, but the text is future-oriented. This should meet the needs of economics and international relations students interested in understanding the systemic forces shaping today's world. Instructors wishing to expose students to a wider range of topics can easily apply the cultural-systemic principles to supplementary readings on other worthy subjects.

INTRODUCTION

I have called this book the *General Theory of Employment, Interest and Money*, placing the emphasis on the prefix *general*. The object of such a title is to contrast the character of my arguments and conclusions with those of the classical theory of the subject, upon which I was brought up and which dominates the economic thought, both practical and theoretical, of the governing and academic classes of this generation, as it has for a hundred years past. I shall argue that the postulates of the *classical* theory are applicable to a special case only and not to the general case, the situation which it assumes being a limiting point of the possible positions of equilibrium. Moreover, the characteristics of the special case assumed by the classical theory happen not to be those of the economic society in which we actually live, with the result that its teaching is misleading and disastrous if we attempt to apply it to the facts of experience.

John Maynard Keynes, *The General Theory of Employment, Interest and Money*, 1963, p. 3.

Comparative economic systems is the branch of economics devoted to investigating the ways in which production potential and performance are affected by motivational, mechanistic, and institutional forces governing demand and supply. Some people conceive the discipline as a catalog of human economic imagination. They enjoy studying how societies conceptualize and design systems like harmonism, communalism, socialism, communism, and capitalism to construct a better world. Some approach the subject from the standpoint of natural selection, chronicling the evolution of historical systems like feudalism and mercantilism, while others adopt a more pragmatic attitude, trying to discover which institutions and systems work best today.

All are valid, but theorists trained in the classical tradition sometimes view comparative systems research as an exercise in futility because they believe history has shown that free enterprise with minimal state participation is superior to all past, present, and future rivals. It is easy to sympathize with this position. The properties of perfectly competitive economies are extremely desirable, and the postwar successes of liberal capitalism suggest that the more closely real economies correspond with the competitive ideal, the better they perform.

But matters are not really so simple. Textbook models of perfect market competition are not as ideal or complete as they seem. Their attributes depend on special assumptions

2 Introduction

about technology, information, market access, patentable innovations, and the infallibility of price and quantity adjustment mechanisms (the invisible hand). They disregard government regulation, programs, and transfers, as well as obligation, and of course, the performance of real economies frequently defies classical expectations. Japan's managed system spectacularly outperformed the American liberal model from the early 1960s until the 1990s on most measures.

It is therefore essential to realistically model and scientifically evaluate the performance of different economic systems instead of assuming that globalization will soon render diversity extinct. This is accomplished here by elaborating the core micro- and macroeconomic principles applicable to all economies, and explaining how they are modified by national cultures into distinctive economic systems. The text clarifies conceptual misunderstandings about the comparative merit of free competition and perfect governance, showing in many cases how the same results are attainable using either mechanism, or by combining them. And it illuminates why engineering variables like the quantity and quality of fixed and variable inputs, management, entrepreneurship, technological progress, and economic governance do not adequately explain disorders like the increasing poverty of the world's poorest nations. The alternative approach developed here elucidates how culture, politics, and economic misconduct systemically modify demand, supply, effort, know how, discipline, innovativeness, compensation, income distribution, and social welfare, with special attention devoted to America (as an example of the Anglo-American model), Continental Europe, Japan, China, and Russia. This fresh perspective, which in the spirit of Keynes broadens the scope of general economic utility-seeking behavior, reveals profound global economic trends masked by the old focus. Instead of the universal "convergences" implied by worldwide perfect competition and perfect planning, it points to a reconfiguration of global wealth and power. It shows, as many economists long suspected, that the clarity of ideals like general market competition which purport to encompass the totality of national economic conduct may at times be achieved at the expense of true understanding. In a sense this should be obvious. The cogency of the competitive paradigm rests on the notion that utility-seekers will prefer free enterprise because it allows everyone to pursue prosperity on a level playing field. Rational men and women are expected to utility and profit maximize by producing and consuming the things they most desire. They are supposed to shun unfair anticompetitive practices, including criminal misconduct, and always be efficient. But generally competitive systems are nowhere to be found. People who are assumed to be individually self-seeking, ethically disciplined, and efficient persistently refuse to adhere to their scripts because their actions are culturally constrained, and they are often mismotivated, and unscrupulous.

This problem extends beyond national borders to international economic and security relations. Political scientists like Samuel Huntington conceptualize international affairs as a clash of civilizations, where power, not just competition, is paramount. Anglo-American culture, and the generally competitive principles it espouses, in Huntington's view are unique, not universal; a fact which fundamentally alters the terms of global economic engagement.

Most students and scholars sense these tensions, but like the architects of the transition theory known as the "Washington Consensus" still succumb to rationalist idealism. This is fatal because it always leads back to the misleading inference that all market economies and civilizations are, or soon will be, efficient and broadly alike. The snare is avoided here

by elaborating the entire tapestry of systems theory including international relations from first principles.

The details of this new systems theory and its international ramifications are developed step by step in five parts. The first provides the conceptual building blocks connecting principles with systems models. It also addresses thorny matters like the role culture plays in influencing economic behavior. Part II specifies, explains, and evaluates two archetypes: perfect free enterprise (competitive markets) and perfect governance (command), to establish benchmarks for appraising economic performance. Part III delineates the market systems of America, Continental Europe, Japan, China, and Russia, explains their properties, and considers the problem of post-communist transition. Part IV elaborates the postwar economic performance of the great powers, and 169 other countries, and extrapolates trends, qualified by a discussion of the statistical pitfalls clouding comparative analysis of disparate systems. Part V integrates systems and international relations theory. It presents a fact profile of global military capabilities and carries the investigation to conclusion by discussing practical ways to diminish the negative consequences of systems rivalries and global economic engagement.

PART I

SYSTEMS

CHAPTER 1

COMPARATIVE ECONOMIC SYSTEMS

Economics is the study of economic utility-seeking under conditions of scarcity at work and play, and implies rational choice. It tacitly assumes that the utility sought is exclusively associated with consuming goods and services including leisure. Vindictive utility-seeking, which diminishes personal welfare by subordinating rational choice in order to get even with enemies, is noneconomic. People may feel better relinquishing reason for malice or love, and act sensibly on this basis, but their behavior is explained by psychological, physiological, cultural, and ethical principles properly the domain of other disciplines.

The collective outcomes of individual utility-seeking are shaped by people's preferences, technologies, mechanisms, institutions, and rules of personal interaction. These elements are the building blocks of economic systems.

The performance of economic systems can be evaluated "positively" by monitoring variables like the size and growth of the gross domestic product, and "normatively" by making value judgments about matters like income distribution and social justice.

Theoreticians frequently try to assess both the "positive" (technical efficiency), and "normative" (welfare) dimensions of aggregate economic activity by making assumptions about the rules of the game governing utility-seeking. If perfect competition, or perfect planning, is assumed it is relatively easy to interpret economic outcomes and offer policy guidance.

However, perfect competition and perfect planning rarely, if ever, occur. They may apply in some activities, but others will be inefficient, imperfectly competitive (planned), obligatory (force), and state-governed (command, administration and regulation).

Ethics, politics, and culture play important roles in determining the performance of systems. Communal cultures may proscribe or constrain individual utility-seeking, fundamentally altering the rules of the economic game, while competitive societies may over stimulate self-seeking. Ideology may also be a factor, but is usually subsidiary. Real economic systems are governed primarily by specific individual motivations, technology, and the rules of interpersonal utility-seeking, rather than idealistic principles.

ECONOMIC SYSTEMS

Economic systems are sets of self-regulating and culturally regulated “utility-seeking” activities transacted through voluntary exchange, reciprocal or unilateral obligation, and assignment, with scarce resources. A utility-seeking activity may involve work (training, producing, managing, financing, distributing, and governing), or leisure. The utility sought can be any experience consumers desire (demand). A utilitarian experience itself is not “economic,” although it usually is the result of “economizing,” understood as the rational choice required to achieve higher levels of utility. Scarcity depends on demand and is connected derivatively with supply side sacrifices called “tradeoffs” or “opportunity costs.” Most utility-seeking activities are economic, but if resources are free, preferences are inconsistent, or rational choice is overwhelmed by passions like domination, malice, and love, these pursuits are noneconomic. The self-regulating principles, or culturally determined rules of conduct governing patterns of utility-seeking in economic units, or nations, and their corresponding mechanisms and institutions, define and distinguish economic systems.

This broad concept of economic systems as diverse self-regulating or culturally shaped utility-seeking search processes pursued through markets, state governance, and obligation, involving the consumption of goods and services in a world with scarce resources, implies that there may be many ways of achieving goals, and that economizing pervasively affects our lives. However, it is often better to utilize a more restricted framework which focuses on work. Although work and leisure both involve utility-seeking, “work” serves as a proxy for the time people devote to producing, while the remainder of the day is reserved for consuming, including romancing, family building, socializing, politicking, and philosophizing. Materially oriented societies stress work over leisure. Spiritual communities may spend more time on contemplation, working only to secure necessities. Often when people speak informally about economics and economic systems, they have this “work–leisure” dichotomy in mind. Economic activity is perceived as “making a living,” as a means to an end (leisure), rather than as a component of a larger economic utility-seeking process which includes leisure. This convention is adopted throughout this text when discussing the gross domestic product, a concept defined exclusively for work activities, but the broader notion of economics as a process covering all scarcity constrained utility-seeking is retained when appraising welfare and comparative economic merit.¹

MECHANISMS AND INSTITUTIONS

Economic activities can be conducted through self-direction, voluntary exchange (markets), and external regulation (obligation and governance). Individuals can command

¹ The extent to which utility-seeking leisure choice should be considered economic depends on one’s attitude toward time. If it is viewed as a scarce factor, then every rational, utility-seeking act is economic. But time cannot be bought and sold, and therefore is scarce in a different sense than labor, capital, natural resources, and land. Some economists therefore prefer to restrict the concept of economic leisure to situations where leisure-time utility-seeking requires the use of conventional scarce inputs, toys, and other paraphernalia.