The Best Cases of "Actually Existing Socialism"

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What is the best case for socialism, historically? In the present day, the two regimes that still fully engage in the collective ownership of the means of production, North Korea and Cuba, are run by totalitarian governments. Venezuela is perhaps the next closest to "true" socialism, but it pairs its brand of socialism with other low-quality institutions as well. This pairing is common historically, ever since countries began adopting socialistic institutions in earnest in the early twentieth century.[1] Scholars sympathetic to socialism are rightly apprehensive toward the association of socialism with the bad historical economic and humanitarian outcomes in countries such as North Korea and Cuba or the Soviet Union and China before reform.

The differences between the economic systems of countries with a professed ideology of socialism and what appears on the pages of *Das Kapital* has led to the phrase "actually existing socialism," denoting the socialism practiced within Eastern Bloc countries. If the conventional definition of socialism holds and the means of production are collectively held, then the Eastern Bloc countries were socialist, even if this socialism was paired with dysfunctional institutions and repressive political regimes (as is the case in present-day North Korea and Cuba).

Elsewhere, emphasis has been placed on *democratic socialism*. In practice, this term has often meant democracy with a very heavy-handed intervention in markets. But it can

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1. With additional forerunners—for example, early Anabaptists—as argued in Kautsky 1897, 155–292.

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also contrast "socialism" with "capitalism" insofar as economic decision making should reside in the democratic will of the people rather than (in the eyes of socialism's proponents) in the allocative decisions of corporate executives and others holding wealth. This is what is meant by "democracy" in the phrase "economic democracy" and as advocated by, for example, Nancy MacLean (2017). It is in this specific sense that "socialism," taken to necessitate *both* the collective ownership of the means of production *and* the allocation of resources determined directly by democratic will, has truly never been tried, though some countries have had or do have collective ownership of the means of production.

But if the missing ingredient of successful socialism is democracy, can a concept of "actually existing democracy," so to speak, be used to identify the best historical outcomes for "actually existing socialism"? Liberal-democratic institutions pervade the world in the twenty-first century and can be readily identified using measures such as the Polity IV Index. Of course, the types of democratic political institutions whereby all allocative decisions are made seamlessly through something akin to direct democracy, as described by socialists, do not presently exist and have never existed. Meanwhile, liberal-democratic institutions tend to be positively correlated with countries that have more economic freedom, if anything (Lawson and Clark 2010; Bjornskov forthcoming). F. A. Hayek (1944) outlined long ago the reasons for the difficulties in making the combination of high-quality, liberal-democratic institutions and socialism work (see also Friedman 1962).

If we use the Economic Freedom of the World (EFW) Index (Gwartney, Lawson, and Hall 2017) to identify the modern-day countries with the least economic freedom and the Polity IV Index as a measure of democracy, the present-day country that best pairs liberal democracy with the absence of economic freedom is Argentina. In 2016, Argentina scored a 9 on Polity IV's −10 to +10 scale, just short of the rating for the most democratic country and actually slightly higher than the score given to the United States.[2] But Argentina also received the fifth worst score on the EFW Index for 2017. Besides Argentina, the countries with the most democracy and least economic freedom are Myanmar and the Central African Republic. Based on those examples, it is not obvious that combining liberal-democratic institutions with socialistic institutions will yield notably better outcomes for socialism than outcomes in North Korea, Cuba, and Venezuela.

"Actually existing democracy" may not operationalize effectively as hoped. So instead of focusing on democratic political institutions to identify the best case for socialism as it has actually existed, we might rather consider the strength of a country's other government institutions. Countries that embrace a socialist ideology—in other words, that score very low on the EFW Index—are frequently governed by regimes that are incapable of actually exerting control over a country's economy. Some countries

2. This change was very recent. The United States held a perfect score from 1974 to 2015. Argentina's score has been tumultuous throughout its history.

combine significant statutory intervention in the economy with a state incapable of even spending more than a small proportion of a country's income (e.g., Chad). Other countries with very low EFW scores have long been dominated by populists, such as Argentina under the Kirchners and Venezuela historically first under Hugo Chavez and now under Nicolás Maduro. And countries frequently cited as successful examples of socialism in popular conversations about "socialism," such as the Nordic countries, merely combine extremely effective states with fairly high levels of economic freedom, according to the EFW Index.

Another way to approach the question of what a "good" "actually existing socialism" might look like would be to see which countries historically have combined extremely capable states, similar to those governing present-day Nordic countries, with very low levels of economic freedom. Where has there been a large, effective, functioning state with little economic freedom? Answering this question, especially for the years before the fall of the Iron Curtain, presents data issues because such data were relatively sparse until recently.[3] However, an index more recently developed, the State Economic Modernity (SEM) Index (Murphy 2017), which uses only components of the EFW Index, may help provide an answer. It measures both the pure size of states and their willingness and ability to provide the key public goods associated with justice, law, and property rights. Countries that score highest in this index, as described in greater detail in the following section, are the strongest social democracies in the world. Countries that score the lowest in state economic modernity may have low economic freedom (such as Chad) or may have high economic freedom (such as Guatemala).

Therefore, one question that we can ask is, Which countries have historically had low economic freedom while also being governed by states with high state economic modernity? Although this question is not precisely the one posed by modern advocates of socialism, it does ultimately split the difference between the modern, high-quality social democratic states (e.g., Denmark) and "actually existing socialism" in practice, without invoking the need for the presence of empirically nonexistent political institutions for a country to count as socialist.

When this exercise is performed and applied to the year 1985, three countries can be identified as simultaneously embodying strong, effective modern states and socialist economic institutions: China, Hungary, and Israel. There is a name for the particular brand of socialism practiced in each of these countries—"socialism with Chinese characteristics" in China, "goulash communism" in Hungary, and, arguably at least, kibbutzism in Israel. It is notable that although by 1985 Hungary and Israel had achieved higher standards of living than other socialist countries and China was about to embark on the greatest period of sustained economic growth in human history, all three were already in the midst of recognizing the need for reform away from socialism. China and Israel had already begun a very long series of reforms by the end of the 1970s, and

3. For example, the World Bank did not begin its collection of development indicators, known as Worldwide Development Indicators, until 1996. See World Bank n.d.

Hungary had already "reformed" relative to other Eastern Bloc countries and was only prevented from doing more by Soviet authorities. This ultimately suggests that although other factors, including better institutions, can support better economic performance than the picture painted by the harshest horror stories of socialism, those who live under the best cases of "actually existing socialism" still recognize the need to move toward more economic freedom. As shown later in this article, all three of these countries not only increased their economic freedom (which would put them roughly in the same place as the Nordic countries) but also reduced the size of their state's footprint in the economy.

In the next section, I describe the EFW and SEM Indexes in greater detail as well as their relationship to one another. Then I lay out the issues in applying the two indexes to demarcate what counts as the best case of "actually existing socialism," finding that the three countries mentioned—China, Hungary, and Israel—fit the definition the best. Finally, I consider these countries individually and describe what each case may allow us to say generally and add concluding observations.

Data on Economic Freedom and State Economic Modernity

Economists frequently cite the quality of institutions as an important element of economic development (North 1990; Knack and Keefer 1995; Williamson 2000; Acemoglu and Robinson 2012). The institutions of economic freedom have historically been seen as an important aspect of institutional quality (Hayek 1960; Friedman 1962; Mises [1927] 1985). And although institutions themselves are abstract concepts that are difficult to operationalize, social scientists have made significant progress in quantifying many conceptualizations of institutional quality, including economic freedom.

The EFW Index assembles forty-three different pieces of data collected from outside sources into five categories: (limited) size of government, the quality of the legal system and property rights, sound money, freedom to trade internationally, and regulation. All components are scored such that a 10 indicates maximum economic freedom and 0 minimum economic freedom. Most recently, an adjustment for gender disparity in economic freedom, as developed by Rosemarie Fike (2017), was implemented into the scoring of the legal system and property-rights component. Jakob De Haan, Susanna Lundstrom, and Jan-Egbert Sturm (2006) have established at length the relationship between economic freedom and economic growth, and Joshua Hall and Robert Lawson (2014) review the literature on the other effects of economic freedom. The EFW Index begins in 1970 and is measured every five years through 2000, at which point it is available every year. Early years have a limited number of countries, with each subsequent year adding additional countries; a total of 159 countries were scored for 2015, the most recently available year. By 1985, the year that is the focus of this paper, the number of countries being scored was 110. I use the year 1985 to maximize the number of countries being rated while the world was still living under the shadow of socialism.

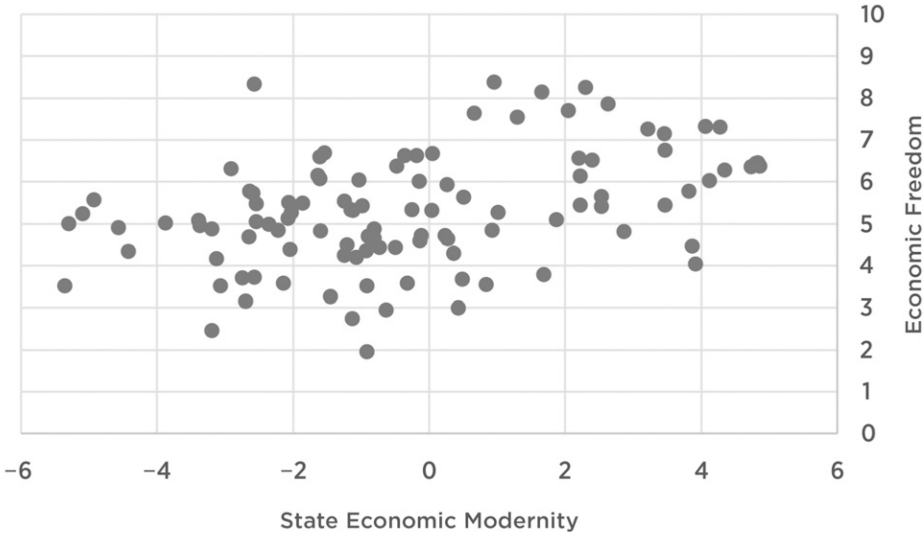
The SEM Index (Murphy 2017) develops a new measure of institutions by making use of the EFW data that stretch back to 1970 to construct an index that is conceptually similar to state capacity. Rather than measuring what is hypothetically possible for a state to do, as state-capacity measures do, an assessment of state economic modernity measures the extent to which a state in practice exerts itself within an economy, as demonstrated by both its economic footprint relative to the size of the economy and how well it provides the essential public goods of law and order. As an example of how state economic modernity differs from state capacity, consider how both Sweden and Singapore rank very highly in state capacity in that Singapore effectively accomplishes whatever it sets out to do, just as Sweden does. However, Singapore possesses only middling state economic modernity because it limits its overall state footprint within the economy.

The SEM Index is constructed by taking the legal-system and property-rights ratings in the EFW Index and *subtracting* the (limited) size-of-government variable. Though counterintuitive, this approach means in practice that countries with large states and effective provision of law receive high scores, whereas countries with neither receive low scores. The top ten in the index for 2015 are Sweden, Finland, Netherlands, Norway, Luxembourg, Denmark, Belgium, Iceland, Austria, and Japan. The bottom ten in the index are Madagascar, Bangladesh, Haiti, Guatemala, Honduras, Cameroon, Central African Republic, El Salvador, Pakistan, and Paraguay. The index scoring runs hypothetically from −10 to +10, although all countries in 2015 received scores between −6 and +5.

There is a slight, positive relationship between state economic modernity and economic freedom, although in some sense they are unrelated to each other mechanically because state economic modernity simply takes one piece of the index and subtracts it from the other. One benefit of the SEM Index, to be discussed further later, is the intuitive groupings of country institutions it provides when paired with the EFW Index and when both indexes are plotted against each other on a Cartesian plane. But there are other benefits, as discussed in Murphy 2017. What is most of interest here is that the primary indicator for state capacity is the "government effectiveness" component of Worldwide Governance Indicators, but these data are available only going back to 1996 and only for select countries. It would be impossible to study socialism for the period when it was a true global force given the time constraints of the government-effectiveness variable, but it is possible using state economic modernity.

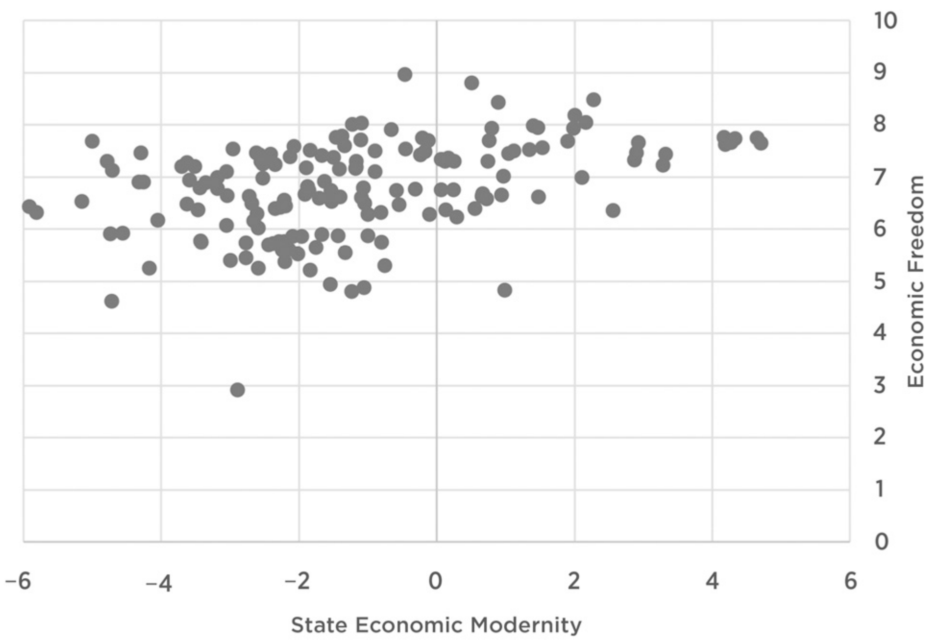
Suppose state economic modernity is mapped to the *x* axis and economic freedom is mapped to the *y* axis, as shown in figure 1, which presents the data for 1985, and figure 2, which presents the data for 2015, the most recently available year. There is a weak, positive relationship in both figures. In the 2015 data (figure 2), a tight grouping of countries is to the far right in the upper-right quadrant: Sweden, Finland, Netherlands, Denmark, Norway, and Luxembourg. Up and to their left are countries associated with the United Kingdom—New Zealand, Ireland, the United Kingdom itself, and Canada, all of which are very close to one another. Murphy 2017 discusses these groupings at greater length, assessing all 159 countries according to their economic institutions.

Figure 1
State Economic Modernity and Economic Freedom, 1985



Source: Murphy 2017; author's calculations.

Figure 2
State Economic Modernity and Economic Freedom, 2015



Source: Murphy 2017; author's calculations.

The weak, positive relationship between the two variables is primarily the result of fewer data points in the lower-right-hand quadrant of figure 2. This is exactly the area where we should look for countries with both modern states and low economic freedom. For 2015, there was only one country with an economic modernity score greater than 0 and an economic freedom score less than 6 (Algeria). But in 1985 there were several countries within that quadrant. In the following section, I consider the semantics of how to define socialism and modern states in terms of index values in order to identify which countries are maybe the best cases of "actually existing socialism."

Identifying Socialism with Well-Functioning States

Countries with low economic freedom do not perfectly align with countries that identify themselves as socialist or communist. Explicitly socialistic countries rated by the EFW Index in 1985 were Benin (ranked 89 of 110), Bulgaria (40), China (73), Republic of Congo (88), Hungary (82), Poland (96), and Romania (41). Other countries that received scores and may have considered themselves socialist at the time include Algeria (ranked 97 out of 110), Bangladesh (97), Egypt (74), Guyana (104), India (74), Madagascar (90), present-day Myanmar (102), Nepal (57), Sri Lanka (76), Syria (106), and Tanzania (93). Certain countries that did not view themselves as socialist—including Argentina (100), Bolivia (102), Brazil (107), present-day Democratic Republic of the Congo (100), Ghana (105), Nicaragua (110), Peru (109), and Uganda (108)—had less economic freedom than many self-identified socialist countries.

Economic freedom, as measured by the EFW Index, has seen a secular increase across the world for many decades. For example, the problem of inflation, which makes up one-fifth of the index, has effectively been eradicated from entire continents when compared to the worldwide inflationary phenomenon in the second half of the twentieth century. In the EFW Index, the global average score for 1985 was 5.30. In the most recent report, only 9 countries out of 159 received scores lower than 5.30—Chad, Myanmar, Syria, Libya, Argentina, Algeria, Republic of the Congo, Central African Republic, and Venezuela (Cuba and North Korea, the two obvious omissions, did not receive a score due to data limitations). Taking these issues together, I decided on a cutoff score of 5 in the EFW Index as a line demarcating socialistic institutions, even though this means that a large number of countries as of 1985 will be demarcated as socialist.

One could object to this definition of socialism on a few different grounds. To what extent is "socialism" simply the same as "the absence of economic freedom"? Countries with institutions so weak that they are highly interventionist on paper but are incapable of doing very much with that capacity (as in Chad) may not be properly labeled as "socialist." Moreover, on the one hand, a functioning court system that respects the rule of law may be interpreted as hardly contradicting socialism (socialism does not necessarily prevent judges from acting impartially), but, on the other hand, the abrogation of the rule of law may necessarily follow the logic of central planning (as in Hayek 1944). Ultimately, however, neither of these issues is problematic for the exercise here because in the next step we will be conditioning on identifying countries with strong states with at least somewhat functional legal systems.

Choosing the correct SEM cutoff point is even more arbitrary. When data corresponding to 2015 are used to get a sense of the meaning of the index numbers, the elite socially democratic countries (Demark, Luxembourg, Norway, the Netherlands, Finland, and Sweden) have scores higher than 4.0, and the second tier of such countries (France, Japan, Austria, Iceland, and Belgium) score at or a little higher than 3.0. Simply using 0 for the SEM cutoff will include in the numerical definition of "large, modern, effective state" wealthy countries that explicitly limit the economic power of their governments (such as Singapore and the United States) as well as countries that have simply less state capacity (such as Azerbaijan and South Africa). Because Germany, Canada, and Ireland receive scores of around 2.0 for 2015, this rating was ultimately used as the cutoff. But I later relax this definition and the definition for socialism using the EFW Index.

With all these assumptions in place, we can demarcate which countries most closely combined the modern governmental economic power of the most effective European states with socialism. The countries that conform to this definition are China (4.82 EFW, 2.87 SEM), Hungary (4.48 EFW, 3.86 SEM), and Israel (4.04 EFW, 3.92 SEM). If we relax the SEM definition from 2.00 to 1.00, then the only country that will be added is Tanzania, while lowering the cutoff to 0.50 causes Zambia to be added (neither of these countries had strong legal systems in 1985, but their levels of government spending demonstrated very high fiscal capacities). If we return the SEM cutoff to 2.00 and relax the EFW definition to 6.00, the countries that can be added are Botswana, Iceland, Italy, Kuwait, and Portugal. Although China, Hungary, and Israel as of 1985 may not seem to obviously exemplify the best cases of "actually existing socialism," these countries were the ones (among the ones receiving ratings) that closely combined socialism with strong, effective states. Fortunately, as previously mentioned, all three exhibit forms of socialism that have been well studied and have names—socialism with Chinese characteristics, goulash communism, and (to some extent) kibbutzism.

China, Hungary, and Israel as the Best Cases of "Actually Existing Socialism"

Table 1 displays a variety of social indicators for China, Hungary, and Israel in or around 1985 and 2015: real gross domestic product (GDP) per capita, the Gini coefficient, education, infant mortality rates, and life expectancy. All have improved under capitalism, except for the Gini coefficient,[4] which has risen in both Hungary and China (but stayed about the same in Israel). Data on poverty through the World Bank are sparse,

4. For the sake of exposition here, inequality as measured by the Gini coefficient is assumed to be a social bad.

but poverty has certainly decreased in China. It is unclear what has happened in Israel, and it is possible that poverty has risen in Hungary in the past thirty years. Overall, the data suggest that the socialism of Hungary and Israel was not as dire as the socialism elsewhere, and perhaps China parlayed the strength of its state institutions into its later historic growth rate. China's transformation had already commenced by 1985 under the rule of Deng Xiaoping, leading to a miracle of economic progress that has been documented at length elsewhere—for example, in Coase and Wang 2012 and Zhang 2015. Yet China's reforms are not nearly as complete as many believe, with an EFW Index score ranking it 112th of 159 countries as of 2015.

Hungary under "goulash communism" and the Communist leader János Kadar was liberal and affluent relative to the rest of the Eastern Bloc and was known as "the happiest barracks in the socialist camp" (Frucht 2004, 381), although by 1985 a weakening economy had led to an acceleration in the call for reform (Stokes 1993, 89–91) just as perestroika commenced within the Soviet Union. According to János Kornai (1996), Hungary as it exited communism displayed four characteristics that distinguished it from the rest of the Eastern Bloc following the period of goulash communism: a much greater emphasis on material welfare; a robust welfare state; patient gradualism; and political calm. Ironically, according to Istvan Benczes (2016), the history of goulash communism has ultimately paved the way for the populism that has infected Hungarian politics in contemporary times. This populism has not yet seemed to harm Hungary's economic institutions; its economic freedom score has drifted between 7.0 and 7.5 since 2000 and is currently at 7.3, putting it in a position

Table 1
Social and Economic Indicators for China, Hungary, and Israel: 1985 and 2015

	Real GDP per Capita (Thousands of $ 2010)		Gini Coefficient		Education (Years, 25+)		Infant Mortality		Life Expectancy	
Country	**1985**	**2015**	**1985**	**2015**	**1985**	**2010**	**1985**	**2016**	**1985**	**2016**
China	0.54	6.89	28.9	45.9 (2012)	4.78	7.53 (2010)	42.4	8.5	68.5	76.1
Hungary	8.85 (1991)	14.99	21.7 (1984/1986)	28.2	8.81	12.14 (2010)	19.5	4.4	69.0	76.0
Israel	18.77	33.67	39.9	37.3 (2012)	10.41	12.76 (2010)	12.1	2.9	75.2	82.1

Sources: Data for real GDP per capita, infant mortality rate per 1,000 live births, and life expectancy are from World Bank n.d. The Gini coefficient data come from UNU-WIDER n.d., averaging together all studies found in the database that are not specific to rural or urban areas. Education data are from Barro and Lee 2013.

below its neighbor Romania (7.72), essentially tied with Slovakia (7.31), and ahead of Slovenia (7.00), Croatia (7.02), and Serbia (6.75).

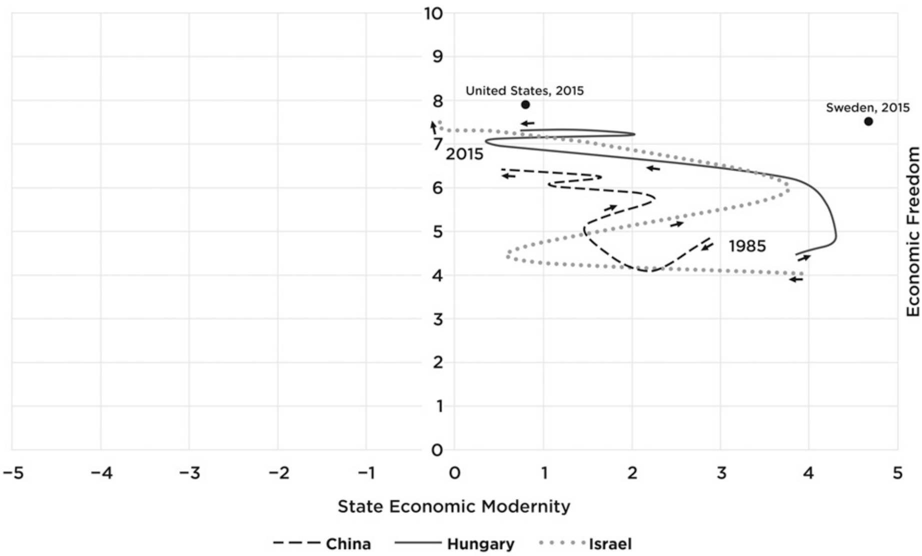
Although nearly all commentators recognize the superiority of Hungary's brand of communism, opinions are more mixed on the interpretation of Israel and kibbutzism. One academic supporter of socialism goes as far as describing Israel during this period as a socialist model, claiming that "[a]fter sixty years of activity, there is no doubt about kibbutz efficiency" (Helman 1992, 168), despite the kibbutz system being in the midst of a steep decline. In contrast, one commentator on the left considers kibbutzism simply a form of ethnic nationalism (Assi 2016). Kibbutzism's decline occurred as market reforms, which began decades earlier, accelerated throughout the 1990s and 2000s (Halevi 2008). Counterintuitively, a catalyst for some of these reforms may have been a large influx of Soviet immigrants (Powell, Clark, and Nowrasteh 2017). The extent of Israeli liberalizations have meanwhile not been recognized as much as they deserve. In 1985, Israel ranked behind Hungary and China in economic freedom; in 2015, it ranked above them even after their own serious reforms. In 2015, Israel, 38 out of 159 countries, ranked ahead of other modern social democracies, such as Japan (39), Belgium (43), and France (52).

But what is most surprising about these economies is the uniform manner in which they have reformed. In very different ways, China, Hungary, and Israel in 1985 had recognized that market liberalization was ultimately necessary. If simply economic freedom had increased, with state economic modernity unmoored, they would have moved themselves toward the position of today's social democracies. Yet they did not do this. Although they improved their economic freedom, they also somewhat dismantled their states, all to a similar degree. As shown in figure 3, simultaneous increases in their EFW Index score and rapid decreases in SEM score can be seen for all three countries from 1985 to 2015. What their reform consisted of was a move not toward the economic institutions of Sweden but toward the economic institutions of the United States, as shown in the figure. On the mapping of economic freedom and state economic modernity, Hungary now is a close neighbor to several other eastern European countries (such as the Czech Republic and Croatia), and Israel is actually quite close to the other Middle Eastern countries that chose to embrace markets (such as Qatar and the United Arab Emirates) . China is neighbor to countries with functional states that have not fully embraced markets (such as Saudi Arabia and Azerbaijan). What this means is that, ultimately, when the best cases for "actually existing socialism" exited socialism, they moved in the direction of the market liberal economies, not of the social liberal economies.

Conclusion

Very low levels of economic freedom are infrequently combined with liberal-democratic institutions found throughout the West—the best counterexample today being

Figure 3
Path of Economic Freedom and State Economic Modernity for China, Hungary, and Israel, 1985-2015



Source: Murphy 2017; author's calculations.

currently reforming Argentina—let alone the use of the democratic will as the sole determinant of resource allocation. If we wish to identify the places and points in time where socialism was combined with otherwise strong state institutions, "socialism" must not be defined in terms of peculiar forms of democracy. I combine the Economic Freedom of the World Index with the State Economic Modernity Index to identify which countries as of 1985 most closely combined socialism with strong, large, capable modern governments. Among countries for which data are available, the three countries adhering most closely to this set of institutions were China, Hungary, and Israel. Each of these countries exhibited forms of socialism that already had its own name—socialism with Chinese characteristics, goulash communism, and kibbutzism. Hungary likely had the highest standard of living among all countries in the Eastern Bloc, and Israel's standard of living far outpaced what would be naively predicted as conditional based on its socialist institutions. China, in the course of liberalizing in 1985, was in the midst of entering a very high rate of economic growth. Thus, with this relatively simple way of identifying the best cases for socialism, a reasonable set of countries was isolated.

However, all three countries that can be identified as the best cases for "actually existing socialism" recognized the issues with having an extensive state apparatus running their economies and sought to liberalize. Not only did all three liberalize, but all three moved in the direction of liberal market institutions like those of the United States, not in the direction of the economic institutions of the Scandinavian model, and in doing so all three weakened the modernity of their states. Although in 1985 China, Hungary, and Israel were the countries closest to one another in terms of their economic institutions, Hungary was actually situated among other eastern and southern European countries, and Israel was quite close to the most market-friendly countries in the Middle East. China remains something of an outlier. Of the three, as measured by the components of EFW Index, Israel liberalized the most within the thirty-year period from 1985 to 2015.

This paper serves both to operationalize the question of what a "good" socialism looks like (that is, when paired alongside strong state institutions) and to demonstrate the scholarly value of employing the Economic Freedom of the World Index and the State Economic Modernity Index in conjunction with one another. In Murphy 2017, the SEM Index is shown to solve certain quasi-puzzles as to why certain countries such as Guatemala appear to have weak institutions but high levels of economic freedom. The simple method involved in constructing the index, which still allows for the investigation of historical questions back to the 1970s, should be able to facilitate the examination of previously untestable hypotheses regarding the interrelationships and relative merits of states' economic power versus the importance of economic freedom.

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