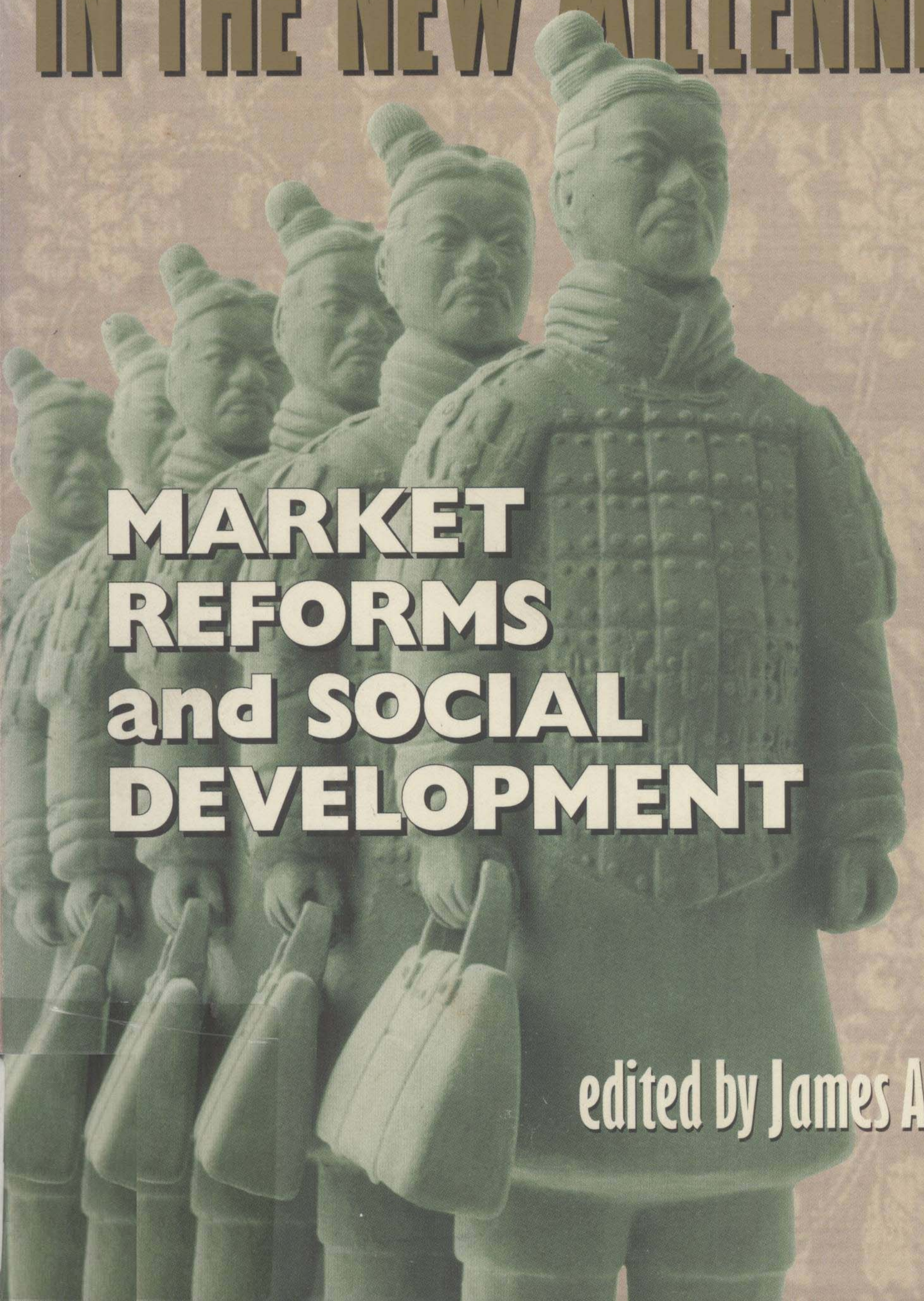
CHINA IN THE NEW MILLENNIUM



MARKET REFORMS and SOCIAL DEVELOPMENT

edited by James A. Dorn

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Contents

1. Introduction—China in the New Millennium

James A. Dorn

> There is no general rule to ensure that all countries or regions should reach the same level of economic attainment or the same rate of progress at any given time or over any given period. Economic achievement and progress depend largely on human aptitudes and attitudes, on social and political institutions and arrangements which derive from these, on historical experience, and to a lesser extent on external contacts, market opportunities and on natural resources. And if these factors favourable to material progress are present, persons, groups and even societies will not stagnate, so that it is the absence of the favourable determinants, and not poverty, which is the causal factor in prolonged stagnation.
>
> —P. T. Bauer
> *Dissent on Development*

China's Market Experiment

China's daring experiment with markets and prices, which began in 1978, has propelled China into the top 10 trading nations in the world. Over the past two decades, China has achieved the fastest economic growth of any national economy, averaging nearly 10 percent per year. If that growth continues, China could become the world's largest economy during the first half of the 21st century.

The continued success of China's journey to prosperity, however, will depend critically on whether its leaders are willing to allow a true market system to develop, in which individuals can hold secure title to their property and are held accountable for their mistakes, or whether China remains a "socialist market economy," in which

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the state plays a dominant role. The question is, Will China follow the path of Hong Kong and adopt market liberalism or continue on the road of market socialism and risk ending the Chinese economic miracle?

The reality is that, unless China can insulate economic life from the state, future economic and social development will be on shaky ground. Indeed, if China is to escape the crippling effects of crony capitalism, now evident in much of East Asia, the institutional clash between markets and socialism in China must be resolved in favor of greater economic freedom. The model for China should be Hong Kong, with its market-supporting institutions. Hong Kong's strict adherence to the principle of nonintervention and the rule of law has allowed it to become the freest economy in the world, and that freedom has produced tremendous wealth and a strong civil society. China cannot afford to ignore those truths.

At the heart of both Kong Kong's success and China's has been the spontaneous nature of wealth creation that takes place within the confines of market exchange. All rational people want a better life for themselves and their children. Free markets provide an opportunity to make the best use of nature's scarce resources and to discover and take advantage of one's talents. Central planning denies people that opportunity and is contrary to human nature. That is why, in the end, it has failed wherever and whenever it has been tried.

The idea of a spontaneous market order—a natural order that benefits individuals and society—is a direct threat to the Chinese Communist Party (CCP), which has a strong interest in maintaining its monopoly of power. The growth of the nonstate, market sector of the Chinese economy has undermined the power of the communist state. Yet, if the market sector is curtailed, the economy will slow and there could be social unrest.

That Chinese puzzle is not easily resolved. China has been moving along in the right direction—markets have been opening, living standards have improved (per capita incomes have quadrupled since 1978), and civil society has grown—but China is still burdened with inefficient state-owned enterprises (SOEs), a banking system riddled with nonperforming loans, and massive poverty, especially in rural areas. Moreover, the Chinese people, now over 1.2 billion strong, have never experienced real freedom.

One of the key features of this book is its emphasis on the relation between the free market, personal autonomy, and social development. Most people now understand that a market economy fosters wealth creation, but they too often fail to perceive how the spontaneous market process promotes individual freedom and human and social progress. This book shows how China's opening to the outside world has enhanced personal freedom and promoted civil society—that is, the nonpolitical space in which individuals voluntarily develop human relations apart from the state.

China's continuing transition from a planned economy to a market economy, as a way to organize economic life, has spilled over into everyday life and added immeasurably to human progress—people are freer to travel, to go into business, to change jobs, to work outside the state sector, to talk with foreigners, to use the Internet, to read foreign literature, and to enjoy themselves than ever before. Although many freedoms are still curtailed, no honest observer would say that China has less freedom today than 20 years ago. This side-effect of material progress is an important part of the Chinese economic miracle that is too often forgotten.

The genesis of this book was the Cato Institute's second Shanghai conference, "China as a Global Economic Power: Market Reforms in the New Millennium," cosponsored with Fudan University's Center for American Studies, June 15–18, 1997. That conference, like the historic September 1988 conference at which Nobel laureate economist Milton Friedman spoke, brought together a group of distinguished scholars and policy experts to discuss the state of China's reforms and China's future. The difference, of course, is that in the interim between the two conferences, communism collapsed in Eastern Europe and the Soviet Union, which no longer exists; the prodemocracy movement in China was quashed in Tiananmen Square; Deng Xiaoping died; Hong Kong reverted to Chinese jurisdiction; and the 15th Party Congress put its stamp of approval on the new leadership going into the next century.

Those events, and the further economic liberalization that occurred after 1988, made the set of issues to be addressed at the 1997 conference different in degree but not in substance. The issue of state versus private ownership remains unresolved; the financial condition of SOEs is bleaker than in 1988, but the causes are much the same; the Asian financial crisis has alerted China to the dangers inherent in state-led investment planning, but those dangers derive from Soviet-style central planning and have been criticized for some time by Western observers; and, most important, the notion that markets can be grafted onto socialist institutions to produce a vibrant "socialist market economy" is a dream that is sure to become a nightmare as China confronts economic reality.

The issue of planning versus the market—that is, of a planned order versus a spontaneous order—remains at the center of the debate over China's future. That issue receives substantial attention in this volume. How it is decided will determine whether private capital markets develop in China or whether investment decisions remain politicized.

The book is divided into five parts: "The Future of China's Market Economy" (Part I), "Lessons for China from Hong Kong" (Part II), "China's Place in the Global Trading Order" (Part III), "Social Development in China" (Part IV), and "Institutional Choice and China's Development" (Part V). A brief summary of each section follows.

The Future of China's Market Economy

Topics covered in Part I include the prospect of China becoming a global "economic superpower," a term Charles Wolf Jr. finds vacuous; the current state of China's economic reforms and the steps needed to make China a true market economy; the problem of whether SOE reform should be gradual or radical; the tensions inherent in a socialist market economy and how those tensions may work themselves out; and the notion of a spontaneous market order and how that order is consistent with ancient Chinese thought, as found in the writings of Lao Tzu.

Lessons for China from Hong Kong

In Part II, attention shifts to Hong Kong and the lessons that China can learn from the world's freest economy. The importance of free trade, sound capital markets, a stable currency, low taxes, and a legal system that protects persons and property against the arbitrary and heavy hand of government are shown to be essential to Hong Kong's success and to China's future.

China's Place in the Global Trading Order

Part III examines the issue of whether China should be admitted to the World Trade Organization and, if so, when and on what terms. Other issues dealing with China's status as a global trading power are considered, including whether China will abide by the rules of a liberal trading order (e.g., with regard to the recent telecom regulatory principles); whether China will further liberalize its foreign exchange regime; and how the U.S.-China relationship may evolve as China gains in economic stature.

Social Development in China

Part IV considers the effects of economic liberalization on the course of human rights and social development in China. Under central planning and state ownership, all economic decisions become political decisions. China's opening to the outside world and the development of a large and dynamic nonstate sector have lessened the power of the central government and provided new opportunities for the Chinese people. Cato Institute president Edward H. Crane explains why China is at a crossroads and must choose between political society and civil society—that is, between coercion as society's organizing principle and freedom. The information revolution comes squarely down on the side of freedom. If China resists that change, it will fail to develop to its fullest.

Minxin Pei and Kate Xiao Zhou provide a rich variety of examples of how greater economic freedom in China has led to a widening and deepening of civil society. An important part of that process, as Tom G. Palmer shows, involves the rise of business enterprise. The millions of individuals who run the small businesses that have mushroomed in China, especially in the coastal areas, comprise a new class that has put a brake on government activism.

Under central planning, the idea of equal shares—the "iron rice bowl" mentality—weakened work incentives and elevated equality to a national virtue. But using the force of government to achieve greater equality is not a virtue, it is a vice. There is nothing virtuous in taking property and income from those who are productive and redistributing it to those who are not. With the onset of reform in 1978, things began to change, albeit slowly, as people recognized the importance of linking effort and reward. Today, the freedom to sell in the open market has increased living standards, but it has also produced a greater disparity of incomes, especially between the fast growing coastal areas and the rest of China. That inequality, however, is not necessarily bad—it represents greater liberty and opportunity to search for profit than has existed in the past. In the future, China will be richer than it would have been if it had stuck fast to the "iron rice bowl" mentality.

The danger is that China will become overly concerned with income inequality and use the power of government to create a large redistributive state modeled after the European welfare states. Such a decision would be a step backwards and slow the market-driven growth that has lifted millions of Chinese out of poverty since 1978.

In his chapter, "Getting over Equality," P. J. O'Rourke equates the quest for equality—in terms of equalizing outcomes—with collectivism and shows why that quest is not only detrimental to wealth creation but immoral as well. Leveling the incomes of rich people, in either the East or the West, is not the way to prosperity or morality.

What China needs to do, argues José Piñera, is to empower people by privatizing assets and allowing people to invest their own money to provide for their own future. That is why he warns China against adopting a national pay-as-you go pension system and, instead, advocates learning from Chile's success with a privately funded pension system. As Michael Tanner points out, the best mechanism for creating a secure retirement income and adequate health-care coverage is the market, not the plan.

Institutional Choice and China's Development

Part V deals with the constitutional, fiscal, and regulatory changes needed to keep China on the road to a freer and more prosperous nation. It is important for China to have "simple tax rules," as Stephen Moore recommends, and to follow Hong Kong's example by adopting a low, flat-rate tax. But it is even more important for China to incorporate any tax change into a constitution that limits government power to tax and to spend and protects individual rights to life, liberty, and property. China's transition from plan to market will not be complete until there is a legal and constitutional framework that protects those natural human rights.

That is why Roger Pilon advocates a "constitution of liberty" for China. "If China is to preserve and expand upon its recent achievements," argues Pilon, "it will need a constitution that institutionalizes, not simply tolerates, the forces that have led to improvements there." The fact that the government has recently allowed F. A.

Hayek's classic 1960 book, *The Constitution of Liberty*, to be published, circulated, and discussed in China is a positive sign.

In the final chapter, Jerry Taylor criticizes the idea of "sustainable development," as it is commonly used by environmental planners. Command-and-control schemes to protect the environment by limiting economic growth are misguided, according to Taylor. The best way for China to achieve a clean environment and a healthier nation is not to hamper markets by overregulation but to harness markets by privatization.

New Thinking

Mao Zedong once said, "Who controls a man's ideas controls the man" (quoted in the *Wall Street Journal* 1998: A14). In 1999, China will celebrate its 50th anniversary under communism. For much of that time, the state had total control over people's lives and that control was exercised, in large part, by controlling the economy. State ownership and central planning meant that almost everyone worked for the government and depended on the government for survival. As such, people had to be political; they had to toe the party line. Civil society, in effect, was outlawed.

With the opening that has occurred since 1978, the idea of economic freedom has been planted on Chinese soil and the tree of liberty has been allowed to grow. Whether that growth will continue will depend on how far China's leaders are willing to go in allowing the Chinese people to explore new ideas and to be free to choose—not only in the marketplace but in all aspects of life. The debate that still needs to be aired in China is the debate over the proper role of government. That debate is now just beginning.

In March 1998, the governor of Qinghai province, Bai Enpei, in a speech before China's legislature, stated, "Things the government shouldn't manage, or can't manage, or manages badly, should be given to enterprises, society, and relevant institutions to manage themselves" (Forney 1998). That attitude, if widespread, will invigorate China.

Difficult issues remain for China; the problem of privatizing SOEs and the question of constitutional reform are perhaps the most fundamental. The future of China as a global economic power will depend on how they are resolved. One thing is clear: without a better understanding and appreciation of the nature of the spontaneous market order, the institutional infrastructure necessary to support that order will not evolve in China. And, if that occurs, social development will also suffer.

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PART I

THE FUTURE OF CHINA'S MARKET ECONOMY