China's Future: Market Socialism or Market Taoism?

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> Though my heart be left of centre, I have always known that the only economic system that works is a market economy, in which everything belongs to someone—which means that someone is responsible for everything. It is a system in which complete independence and plurality of economic entities exist within a legal framework, and its workings are guided chiefly by the laws of the marketplace. This is the only natural economy, the only kind that makes sense, the only one that can lead to prosperity, because it is the only one that reflects the nature of life itself.
>
> —Vaclav Havel
> *Summer Meditations*

China's Grand Illusion

China's goal of building a "socialist market economy" is a grand illusion. The market and its supporting institutions, notably private property and the rule of law, cannot be grafted onto socialism. Markets are based on voluntary exchange; socialism destroys the spontaneous nature of markets and substitutes government control for individual responsibility. Market socialism, even with "Chinese characteristics," is an unnatural and artificial system which, like the Yugoslav experiment with workers' management, is destined to fail.

Without widespread private property, economic decisions—especially investment decisions—will continue to be political decisions and be subject to the corrupting influence of government power. The recent chaos in East Asian currency markets attests to the destructive nature of state-led development policy fueled by "crony capitalism." Government-run banks in South Korea, for example, based their

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lending practices more on political factors than on sound economic criteria (Yoon 1998). Preferential loans to Korea's large conglomerates, the *chaebols*, at below-market interest rates may have maintained the cozy relations among business leaders, bankers, and politicians, but they also laid the basis for a boom-and-bust business cycle. Creating Korean-style conglomerates in China would be a costly error. Letting natural market forces weed out inefficient firms would be a step in the right direction.[1]

China's state-owned enterprises (SOEs) and banks do not need partial reform; they need to be divorced from the state and subjected to the full force of market competition. Turning to the half-measure of market socialism will only prolong the costs of transition to a real market system and continue to politicize economic life. What China needs are "free private markets," not regulated socialist markets (Friedman 1990: 5). Privatization of SOEs would create real owners who were responsible for their firms' performance and had an incentive to maximize profits by hiring efficient managers and producing what consumers wanted.

The absence of a hard budget constraint for SOEs means that bankruptcy is a hollow threat for most of China's 305,000 state enterprises. And the absence of that threat means SOEs have little incentive to change their inefficient ways. As a result, 50 percent of China's 118,000 state industrial enterprises reported net losses in 1996 (World Bank 1997: 28).[2]

Although China's leaders have been willing to sell off smaller SOEs, they have not embraced the idea of large-scale privatization, for obvious political reasons. Selling off all SOEs would relieve China's massive headache due to the financial drain on the state budget of having to subsidize SOEs, but it would also jeopardize the authority of the Chinese Communist Party. With socialism being the dominant ideology in China, there remain serious obstacles to fostering the market component of market socialism. Turning SOEs into "public" corporations, with the state retaining a controlling interest and restricting the marketability of shares, may be appealing at first sight, but on closer examination can never replicate real markets. As economist G. Warren Nutter (1968: 144) noted 30 years ago when he examined the theoretical case for market socialism, "Markets without divisible and transfer-

[1]As Nicholas Lardy points out, China "ought to be relying on a much more competitive market to drive out inefficient firms and allow some natural consolidation to take place" (quoted in Restall 1997: A22).

[2]The actual state of SOEs could be much worse. Hugo Restall (1997: A22) reported in the *Wall Street Journal*, "State firms are desperately sick: as many as 70 percent are losing money."

able property rights are a sheer illusion. There can be no competitive behavior, real or simulated, without dispersed power and responsibility." That is why he called the idea of market socialism "a grand illusion."[3]

To "revitalize" SOEs, China has begun to establish large, state-run holding companies, called "state asset operating companies," which are supposed to substitute for real capital markets (Walker 1997: 6). In this setup, the state retains majority ownership, restricts the transferability of "shares," and limits the restructuring process to what is politically acceptable. Thus, politics, not the market, prevails. That approach to SOE reform is akin to the experiment with perestroika in the former Soviet Union: it is a pseudo-reform that tries to dress SOEs in market garb but never really changes the underlying ownership structure from state to private property. Commenting on the Soviet effort to revitalize state enterprises, Alexander Tsypko (1991: 289) wrote,

> It took us five wasted years of perestroika to understand that, essentially, the revitalization of Stalinist socialism is impossible; there is no third way between modern civilization and socialism as it is. The market cannot be combined with . . . public ownership of the means of production. A return to the market is impossible. . .without broad-based privatization.

The same criticism applies to China's experiment with market socialism.

China's state-owned enterprises cannot be revitalized; they have a terminal disease that is eating up China's scarce capital. In 1996, for the first time since 1949, state enterprises as a whole suffered a net loss—"the state received no return for its massive investment in SOEs" (EAAU 1997: 10). SOEs absorb more than 50 percent of state investment funds, employ 66 percent of the urban workforce, but produce less than 30 percent of total output (EAAU 1997: 338). China's leaders should have the courage to go beyond the policy of "grasping the big enterprises and giving a free hand to the small ones" (*zhua da fang xiao*). All SOEs should be candidates for privatization.[4]

[3]Almost 60 years ago, F. A. Hayek ([1940] 1948: 203) observed, "To assume that it is possible to create conditions of full competition without making those who are responsible for the decisions pay for their mistakes seems to be pure illusion."

[4]Fan Gang (1997: 7) argues that China's "bottom-up" approach to reforming small SOEs may also work for medium and large SOEs, but it will take a long time. That approach allows market forces to bring about spontaneous privatization and then, once proven successful, to legalize it at higher levels. Fan points out that de facto privatization of small SOEs began three years before formal government approval. The "bottom-up" approach is politically attractive because politicians do not have to precommit to ownership reform, so they can take credit for success without having to bear the risk of failure.

Making large SOEs the "pillars" of the national economy by "corporatizing" them, with the government holding all or most of the stock, is a recipe for disaster. That would be market socialism in spades.[5]

From Market Socialism to Market Taoism

China need not be confined to the ideological cage of market socialism by fear of copying Western traditions of market liberalism. The way of the market is universal. The free-market economy is, as Vaclav Havel (1992: 62) so elegantly stated in the introductory quote, "the only natural economy, the only kind that makes sense, the only one that can lead to prosperity, because it is the only one that reflects the nature of life itself." Since 1978, market liberalization has substantially increased the standard of living of millions of Chinese, and a recent poll showed that many Chinese now believe that "private property is sacred.[6] Today more than 22 million entrepreneurs in China are members of the National Association of Private Entrepreneurs (Pei 1997: 4).

The climate is ripe for further market liberalization in China. At the Communist Party's 15th Congress, in September 1997, President Jiang Zemin stood firmly behind Deng Xiaoping's economic reforms and favored turning SOEs into joint-stock companies. And, at the National People's Congress, in March 1998, Premier Li Peng stated, "The incompatibilities of government institutions to the development of a socialist market economy have become increasingly apparent" (quoted in Mufson 1998: A1). China's new premier, economic pragmatist Zhu Rongji, needs to recognize that the only way to eliminate those incompatibilities is by eliminating socialism and moving toward a free society with limited government, the rule of law, and private ownership. The announcement at the NPC that the size of China's civil service will be cut in half and that at least 11 ministries will be abolished or streamlined is an indication that China may be ready to move in the right direction (Kynge 1998, Mufson 1998). Yet, as long as China confines itself to creating a socialist market economy and restricts economic liberties, the future path of China's market economy will remain unclear.

[5]Hugo Restall (1997: A22) writes, "Most of the state-owned enterprises that have been corporatized under the 1993 Company Law are still run as private fiefdoms by management at the expense of the state banks. As long as the state remains in control, it appears, it is impossible to make a credible break from the old days of subsidies and easy credit. . . . Sooner or later the state will have to face up to the need to relinquish both ownership and control."

[6]Minxin Pei (1998:76) reports, "In a 1993 poll of 5,455 respondents in six provinces, 78 percent agreed with the statement, 'Private property is sacred and must not be violated'."

In considering what steps to take next, China's leaders should look to their own ancient culture and rediscover the principle of spontaneous order—the central principle of a true market system.[7] In the *Tao Te Ching* (also known as the *Lao Tzu*), written more than 2,000 years before *The Wealth of Nations,* Lao Tzu instructed the sage (ruler) to adopt the principle of noninterference as the best way to achieve happiness and prosperity:

> Administer the empire by engaging in no activity.
> The more taboos and prohibitions there are in the world,
> The poorer the people will be.
> The more laws and orders are made prominent,
> The more thieves and robbers there will be.
> Therefore, the sage [ruler] says:
> I take no action and the people of themselves are transformed.
> I engage in no activity and the people of themselves become prosperous [*Lao Tzu,* 57; Chan 1963: 166–67].

From a public-choice perspective, the foregoing passage implies that the more the state intervenes in everyday life, the more rent seeking and corruption there will be. Alternatively, if people are left alone to pursue their own happiness, a spontaneous market order will arise and allow people to create prosperity for themselves and their country. Like Lao Tzu, China's leaders should realize that corruption stems not from freedom but from freedom being overly constrained by government. As Nobel laureate economist Gary Becker (1996: 75) stated, "Markets grow up spontaneously, they are not organized by governments, they grow on their own. If individuals are given freedom, they will help to develop markets for products that one cannot imagine in advance."

Just as the principle of spontaneous order is central to economic liberalism, the principle of *wu wei* ("nonaction") is fundamental to Taoism. Rulers rule best when they rule least; that is, when they take "no unnatural action."[8] When government is limited, it can help cultivate an environment in which individuals can pursue happiness and practice virtue (*te*). Thus, Lao Tzu writes, "No action is under-

[7]Nobel laureate economist James M. Buchanan (1979: 81–82) has called "the principle of spontaneous order" the "most important central principle in economics." It is the idea that individuals seeking their own gain in a system of private ownership and free markets bring about mutually beneficial exchanges, and that competitively determined prices coordinate economic decisions without central planning. In fact, central planning cannot lead to the market-determined outcome because no one has sufficient information to know that outcome in advance (see Hayek 1945, Lavoie 1990).

[8]Wing-Tsit Chan (1963: 136) notes that the principle of *wu wei* does not mean " 'inactivity' but rather 'taking no action that is contrary to Nature'." In essence, "*wu wei* . . . is the embodiment of suppleness, simplicity, and freedom" (Smith 1991: 208).

taken, and yet nothing is left undone. An empire is often brought to order by having no activity'' (*Lao Tzu*, 48; Chan 1963: 162).

Like water, the market is resilient and will seek its natural course—a course that will be smoother, the wider the path the market can take and the firmer the institutional banks that contain it. The challenge for China is to widen the *free* market and provide the institutional infrastructure necessary to support *private* markets. The solution is to discard market socialism and make the transition to ''market Taoism.'' Or, as Gao Shangquan, vice minister of the State Commission for Restructuring the Economy, recently stated (in Chang 1997: 15), the challenge is to throw SOEs ''into the sea of the market economy.''

Breaking the Planning Mentality

The collapse of the Soviet Union and the failure of central planning have ended the debate over whether the plan is superior to the market. As Liu Ji (1997), vice president of the Chinese Academy of Social Sciences, recently remarked, ''The only people in China who still cling to the idea of central planning are fossilized, dogmatic Marxists.'' Yet the planning mentality is hard to break—in both the East and the West. It is very tempting for the ''best and the brightest'' to imagine that they can improve upon the ''invisible hand'' of the market. But free markets cannot be planned; they emerge spontaneously as consumers' preferences and technology change, and they require well-defined private property rights and freedom of contract.

The incompatibility of government planning and market forces threatens China's future. The vibrancy of the market-driven nonstate sector, which accounts for more than 70 percent of industrial output value, is propelling the People's Republic into the 21st century, but the ossified state sector—driven by state planners—is acting as a drag on development. The ''heavy-industry-oriented development strategy,'' which is reminiscent of the days of Soviet-style central planning, is still ingrained in the collective consciousness of China's ruling elite (Lin et al. 1996: 218). Without free capital markets and widespread private property, investment decisions necessarily become political decisions. Corruption and rent seeking will continue in China as long as economic decisions are government driven instead of market driven. When the government holds interest rates at artificially low levels, politics—not prices—determines who gets scarce capital. People become dependent on government and lose their foresight and freedom. Moreover, one control leads to others, so that once a government departs from free-market principles, it tends to head further down the ''road to serfdom'' (Hayek 1944; Mises 1980, 1998).

Piecemeal reform creates tensions: the rigidity of the old planning system is pitted against the resiliency of the market. In China, old institutions are giving way to new ones, but not fast enough to eliminate "institutional incompatibility." As Lin et al. (1996: 226) point out,

> The overall performance of China's gradual approach to transition is remarkable, but China has paid a price. Because the reform of the macro-policy environment, especially interest-rate policy, has lagged behind reforms of the micro-management institution and resource allocation mechanism, institutional arrangements in the economic system have become internally inconsistent. As a result of the institutional incompatibility, rent seeking, investment rush, and inflation have become internalized in the transition process. To mitigate those problems, the government often resorts to traditional administrative measures that cause the economy's dynamic growth to come to a halt and retard institutional development.[9]

If China wishes to continue its rapid economic growth into the next century and end corruption, it must strive for institutions that are consistent with free-market principles and the rule of law. That is why Lin et al. (1996: 226) argue, "It is essential for the continuous growth of the Chinese economy to establish a transparent legal system that protects property rights so as to encourage innovations, technological progress, and domestic as well as foreign investments in China."

The Soviet system failed because it disregarded reality—namely, the reality that the way of the market, not the plan, is most consistent with human nature and, thus, with individual rights to life, liberty, and property. Soviet-style planning destroyed the institutions of property and contract that underpin the free private market and created a rigid economic system that finally collapsed of its own weight. What Soviet citizens witnessed during perestroika and glasnost was "not the organic revitalization of socialism but the withering away of forcibly imposed economic and political structures" (Tsypko 1991: 290). Today, China is also witnessing the "withering away" of the state-controlled economy, but its "political structures" still await fundamental reform.

Ultimately, economic and political reform are inseparable. To depoliticize economic life, China needs constitutional change and new

[9]In 1984, China decentralized the allocation of credit by allowing local branches of the central bank to extend credit directly to SOEs. But interest rates were kept artificially low and the banks simply extended new credits, which led to rapid money growth and inflation. Instead of deregulating interest rates, the government reimposed central rationing of credit and directly controlled investment projects. Thus, the "planned system" returned. China's "boom-and-bust cycle" is a result of not going all the way to a market economy and failing to insulate the banking system from political manipulation. Because interest rates are set at below-market levels, nonprice rationing and rent seeking are rampant in the allocation of credit in China. For a discussion of these points, see Lin et al. (1996: 219–20).

thinking (*xin si wei*). Chinese scholar Jixuan Hu (1991: 44) writes, "By setting up a minimum group of constraints and letting human creativity work freely, we can create a better society without having to design it in detail. That is not a new idea, it is the idea of law, the idea of a constitution." To accept that idea, however, means to understand and accept the notion of spontaneous order and the principle of nonintervention (*wu wei*) as the basis for economic, social, and political life.

China's leaders and people can turn to the writings of Lao Tzu for guidance. According to noted Chinese philosopher Wing-Tsit Chan (1963: 137), the *Lao Tzu*

> strongly opposes oppressive government. The philosophy of the *Lao Tzu* is not for the hermit, but for the sage-ruler, who does not desert the world but rules it with noninterference. Taoism is therefore not a philosophy of withdrawal. Man is to follow Nature but in doing so he is not eliminated; instead, his nature is fulfilled.

It is in this sense that Lao Tzu writes,

> When the government is non-discriminative and dull,
> The people are contented and generous.
> When the government is searching and discriminative,
> The people are disappointed and contentious [*Lao Tzu*, 58; Chan 1963: 167].

"Lao Tzu Thought," not "Mao Zedong Thought," is the beacon for China's future as a free and prosperous nation. Deng Xiaoping (1987: 189) implicitly recognized Lao Tzu's way of thinking when he said,

> Our greatest success—and it is one we had by no means anticipated—has been the emergence of a large number of enterprises run by villages and townships. They were like a new force that just came into being spontaneously. . . . If the Central Committee made any contribution in this respect, it was only by laying down the correct policy of invigorating the domestic economy. The fact that this policy has had such a favorable result shows that we made a good decision. But this result was not anything that I or any of the other comrades had foreseen; it just came out of the blue.[10]

Although China can return to its own vision of freedom by embracing and extending Lao Tzu's thought, the idea of "market Taoism" can be enhanced by a deeper understanding of classical liberal economic thought and a study of free-market institutions and public choice. In

[10]Kate Xiao Zhou (1996: 4) describes the demise of China's collective farms and the creation of the household responsibility system (*baochan daohu*), with its township and village enterprises (TVEs), as "a spontaneous, unorganized, leaderless, nonideological, apolitical movement."

breaking the planning mentality, therefore, China can learn both from its own culture and from the West.

The Tao of Adam Smith

In 1776, Adam Smith argued that, if "all systems either of preference or of restraint" were "completely taken away," a "simple system of natural liberty" would evolve "of its own accord." Each individual would then be "left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or group of men," provided "he does not violate the laws of justice" (Smith [1776] 1937: 651).

In Smith's system of natural liberty, the government would no longer have the obligation of overseeing "the industry of private people, and of directing it towards the employments most suitable to the interest of the society"—an obligation "for the proper performance of which no human wisdom or knowledge could ever be sufficient" (Smith 1937: 651).

Government would not disappear under Smith's market-liberal regime, but it would be narrowly limited to three major functions: (1) "the duty of protecting the society from the violence and invasion of other independent societies"; (2) "the duty of protecting, as far as possible, every member of society from the injustice or oppression of every other member of it"; and (3) "the duty of erecting and maintaining certain public works and certain public institutions" (Smith 1937: 651).

In the private free-market system advocated by Smith, people get rich by serving others and respecting their property rights. Thus, the system of natural liberty has both a moral foundation and a practical outcome. Private property and free markets make people responsible and responsive. By allowing individuals the freedom to discover their comparative advantage and to trade, market liberalism has produced great wealth wherever it has been tried. There is no better example than Hong Kong.

The chief architect behind the Hong Kong economic miracle was Sir John Cowperthwaite, a Scot who admired the work of Adam Smith and other classical liberals. As Hong Kong's financial secretary from 1961 to 1971, he constantly challenged attempts to increase the power and scope of government in Hong Kong. Like Smith, he believed that free private markets would keep people alert to new opportunities by quickly penalizing mistakes and rewarding success in the use of society's scarce resources. Sir John understood that no system is perfect but that, of all known economic systems, the market price system, with its automatic feedback mechanism, has performed the best:

> In the long run, the aggregate of decisions of individual businessmen, exercising individual judgment in a free economy, even if often mistaken, is less likely to do harm than the centralized decisions of a government, and certainly the harm is likely to be counteracted faster [quoted in Nancy DeWolf Smith 1997: A14].

The idea that people have a natural tendency to make themselves better off if left alone to pursue their own interests, and the notion that a laissez-faire system will be harmonious if government safeguards persons and property, are the foundation of the West's vision of a market-liberal order, but they are also inherent in the ancient Chinese Taoist vision of a self-regulating order—an order we might properly call "market Taoism" (Dorn 1997).

The Taoist system of natural liberty, like Smith's, is both moral and practical: moral because it is based on virtue and practical because it leads to prosperity. The Chinese puzzle is to discard market socialism and institute "market Taoism" by shrinking the size of the state and expanding the size of the market—and, in the process, to give rebirth to China's civil society.

Market Taoism and China's Civil Society

China's transition from central planning to a market-oriented system since 1978 has been bumpy, but China is moving ahead. Market liberalization has opened China to the outside world, increased opportunities in the nonstate sector, generated new ideas, and energized civil society. That China's civil society has benefited from the end of communal farming, the rise of TVEs, the expansion of foreign trade, and the increased competition from nonstate enterprises should be no surprise. The more economic activity occurs outside the state sector, the more freedom individuals have to pursue their own happiness and lead their own lives. The demand for economic freedom cannot long be separated from the demand for other freedoms.

The market and its supporting institutions follow both formal and informal rules. The informal rules of conduct that underlie the free market, however, are entirely different from the obedience-driven rules of behavior under central planning. Zhang Shuguang (1996: 5), an economist at the Unirule Institute in Beijing, one of China's first private think tanks, writes,

> Mandatory economy and market economy belong to entirely different ideologies and different ethics. . . . Planned economy is based upon some idea of ideal society and beautiful imagination, but

> compulsory implementation has been its only means of realization. In such a system, [the] individual is but a screw in a machine, which is the state, and loses all its originality and creativeness. The basic ethics required in such a system is obedience. In the market system, which is a result of continuous development of equal exchange and division of labor, the fundamental logic is free choice and equal status of individuals. The corresponding ethics in [the] market system is mutual respect, mutual benefit, and mutual credit.

Understanding those differences is the first step in China's long-march to "market Taoism."

Although China has yet to accept the rule of law, a legal system is emerging and property rights are beginning to be respected. Informal codes of business behavior are being adopted to better serve consumers and to improve the efficiency of exchange. The opening of the legal system is important because it paves the way for the transition from "rule by law" to "rule of law." Marcus Brauchli (1995: A1) of the *Wall Street Journal* writes,

> The state's steel-clad monopoly on the legal process, which makes the courts just another arm of government, is corroding. China's economic liberalization . . . has spawned a parallel legal reform that raises the prospect of rule of, not merely by, law.

Princeton University professor Minxin Pei (1994, 1995) argues that the gradual development of China's legal system toward affording greater protection for persons and property, the growing independence and educational levels of members of the National People's Congress, and the recent experiments with self-government at the grassroots level will help transform China into a more open and democratic society. He points to the upward mobility of ordinary people, occasioned by the deepening of market reform, and to the positive impact of China's "open-door" policy on political norms. In his view, public opinion and knowledge of Western liberal traditions, such as the rule of law, "have set implicit limits on the state's use of power" (Pei 1994: 12).

People are beginning to use the court system to contest government actions that affect their newly won economic liberties. According to Pei (1994: 12), "The number of lawsuits filed by citizens against government officials and agencies for infringements of their civil and property rights has risen sharply, and an official report reveals that citizens have won about 20 percent of these cases."

Anyone who has visited China's booming coastal areas and new urban centers, such as Shishi in the province of Fujian, can see firsthand the transformation of economic life that is occurring every day in China and witness the regeneration of civil society.[11] Commenting on China's cultural transformation, Jianying Zha (1995: 202) writes,

> The economic reforms have created new opportunities, new dreams, and to some extent, a new atmosphere and new mindsets. The old control system has weakened in many areas, especially in the spheres of economy and lifestyle. There is a growing sense of increased space for personal freedom.

China has a long way to go, but denying China most-favored-nation trading status or imposing sanctions on China with the hope of advancing human rights, as some in the U.S. Congress have threatened to do, would be a costly mistake. It would isolate China and play into the hands of hard liners who are critical of market liberalization, thereby undermining the prospects for further reform. The best way to advance human rights in China is not to close China off from the civilizing influence of trade, but to continue to open China to the outside world (Dorn 1996). That will be a slow process, no doubt, but the progress made since 1978 should not be underestimated.

In the coastal community of Wenzhou, for example, there are now more than 10,000 private enterprises, and life is vastly different and freer than before liberalization. According to Ma Lei (1998: 6):

> The development of the private sector has fundamentally changed the way residents of Wenzhou look at the world. Traditionally, Chinese peasants lived by the motto, "facing the earth with the back toward the sky." They were tied to their land. Where they were born was, almost always, where they would work and where they would die. Their options were limited in the extreme. In comparison, a child born in Wenzhou now has an endless number of choices. He can decide to work the land or work for an industrial firm or even start his own business. Market forces have broadened the horizons of Wenzhou residents and educated them to the ways of the world. They have learned that in a market economy entrepreneurs frequently fail. But they have also learned that risk taking, when combined with foresight and hard work, can produce significant rewards—a fact that many business owners in Wenzhou appreciate.
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> Most important, the people of Wenzhou realize that on the market all is harmonious—that one earns his living not through coercion or brute force but by serving others. That realization has produced a climate in which private industry and private organizations—including private schools—can thrive.

[11]For a discussion of China's emerging civil society, see Pei (1997). Kathy Chen (1996) describes the model of development in China's new urban centers, such as Shishi, as "*xiao zhenfu, da shehui*—small government, big society—which advocates less involvement by cash-strapped governments and more by society."

The Path to China's Future

In the long run, market socialism, like central planning, is bound to fail because it is contrary to human nature. For more than 70 years, various forms of socialism were tried in the Soviet Union—with no success. Why should "market socialism" succeed in China? Adding an adjective to socialism—even if it is "market"—will not cure the institutional inconsistencies in China. As Soviet dissident Vladimir Bukovsky (1987: 127) wrote in *To Choose Freedom*,

> Those of us who have lived under socialism exhibit the once bitten, twice shy syndrome. Perhaps Western socialism is in fact different and will produce different results. . . . The truth of the matter is that the various ideas that seem fresh and innovative to Western specialists have already been tested in the USSR. And if some of those experiments were eventually repudiated, it was not because socialism has been perverted in the USSR, . . . , but because these innovations proved to be utterly unfit for real life. A cruel experiment half a century long has failed to alter human nature.

The "fatal conceit" inherent in the Soviet vision was to think that government planners could run an economy like a machine and achieve long-run prosperity (Hayek 1988). Although China has recognized the error of central planning and has introduced a market system, that system is still half-baked. The question is: Will China move all the way to market liberalism or remain mired in market socialism? Will China jump into the sea of private enterprise or remain suspended in a trancelike state under the illusion that market socialism will solve its problems?

In considering that question, China's leaders would do well to heed the advice of Nien Cheng—who, like many in China, suffered the grave injustices of the Cultural Revolution. She writes (1990: 334),

> China is faced with the choice between socialism and a market system; a mixed system is doomed to failure. The obstacles to China's development can be removed only if China goes all the way toward a private market system with constitutional protection for both economic and civil liberties. China's crisis is a crisis of confidence; the people are in a half-awakened state of mind. The old regime has lost its legitimacy but a new regime has not emerged to fill the vacuum, and there has been no clear commitment to the path of markets and freedom of choice.
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> To regain consciousness and emerge from the semi-conscious state that now envelops China will take time. But reality requires that China recognize the death of communism. Reality also requires that China embark on thoroughgoing reform or face the prospect of being left behind in the wake of the liberal revolution that is now sweeping the globe.

China has been willing to experiment with institutional change since 1978 and has made great progress in reducing poverty. Future prosperity, however, will depend on whether China turns away from the artificial path of market socialism and follows the natural path of market liberalism. The market-liberal vision is not new to China; it was inherent in the Taoist doctrine of *wu wei* developed by Lao Tzu and his disciples. China's leaders need only let the Chinese people return to their roots to see the wisdom of letting the spontaneous market process organize economic life, while limiting government to the protection of life, liberty, and property. In that effort, Hong Kong can play an important role by spreading the "tao" of Adam Smith and Sir John Cowperthwaite to all of China—thus allowing the West and the East to meet in one spirit of "market Taoism."

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