

**How China Escaped Shock Therapy:
The Market Reform Debate**

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Blurb

Isabella Weber is an assistant professor of economics at the University of Massachusetts, Amherst, and the research leader for China at the Political Economy Research Institute.

China has deeply integrated into the world economy. Yet, gradual marketization has facilitated the country's rise without leading to its wholesale assimilation to global neoliberalism. *How China Escaped Shock Therapy: The Market Reform Debate* uncovers the fierce contest about economic reforms that shaped China's path. In the first post-Mao decade, China's reformers were sharply divided. They agreed that China had to reform its economic system and move toward more marketization—but struggled over how to go about it. Should China destroy the core of the socialist system through shock therapy, or should it use the institutions of the planned economy as market creators? With hindsight, the historical record proves the high stakes behind the question: China embarked on an economic expansion commonly described as unprecedented in scope and pace, whereas Russia's economy collapsed under shock therapy. Through her extensive research, including interviews with key Chinese and international proponents and World Bank officials as well as insights gleaned from unpublished documents, Weber charts the debate that ultimately enabled China to follow a path to gradual reindustrialization. Beyond shedding light on the crossroads of the 1980s, she reveals the intellectual foundations of state-market relations in reform-era China through a *longue durée* lens. *How China Escaped Shock Therapy: The Market Reform Debate* delivers an original perspective on China's economic model and its continuing contestations from within and from without.

Endorsements

One of the most consequential economic debates in China over the direction of reform took place in the 1980s and focused on how markets should be created. The outcome of that debate set the pattern for much of China's subsequent economic reforms. Isabella Weber, drawing on interviews of the participants and others together with many new sources of unpublished and published information, does a masterful job of explaining how this debate evolved and its ultimate impact.

Dwight H. Perkins, Harold Hitchings Burbank Research Professor of Political Economy, Harvard University; former director, Harvard Institute for International Development

This superb book presents the most compelling interpretation I have read of the sources of Chinese gradualism and its success in fostering economic growth and transformation while preserving enough social cohesion to hold the Chinese society together. It is the product of an independent, inquisitive, open mind—

the only type that can hope to grasp the phenomenon that is modern China. It is also the work of a first-rate economist, in the best sense of that term.

James K. Galbraith, Lloyd M. Bentsen Jr. Chair, the University of Texas at Austin;
former chief technical adviser to China's State Planning Commission for macroeconomic reform

Isabella Weber's book gives an excellent historical overview of China's economic statecraft, bringing the reader to the crucial period of market reforms and to the decision to avoid the full implementation of the neoliberal agenda, thus setting the stage for the fastest and longest growth in world history.

Branko Milanovic, London School of Economics Centennial Professor, the City
University of New York; former lead economist, World Bank Research Department

This book is a call to economists to ponder the relevance of political economy, with its European roots in classical economics of the early modern era, with Chinese roots in a period almost two millennia earlier. Isabella Weber articulates this call, focusing on the price mechanism as the core of how economists theorize markets. She succeeds in offering a powerful account of China's early reform-era market creation that is of acute interest to economists and historians alike.

R. Bin Wong, director, Asia Institute at the University of California, Los Angeles;
Distinguished Professor of History, University of California, Los Angeles

China's debates in the 1980s about reform of the non-market economy are centrally important to understanding global political economy in the twenty-first century. The resolution of the debates about the "Big Bang" set China on the course of pragmatic system reform ("groping for stones to cross the river") that has remained in place ever since. Isabella Weber's study is unique. It uses information not only from a wide array of written documents but also from extensive interviews with participants in the debates. Her remarkable book provides a rich, balanced, and scholarly analysis which illuminates the complex reality of this critically important period in modern world history.

Peter Nolan, director, China Centre, Jesus College, Cambridge; founding director, Centre
of Development Studies, University of Cambridge

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Introduction

Contemporary China is deeply integrated into global capitalism. Yet, China’s dazzling growth has not led to a full-fledged institutional convergence with neoliberalism.¹ This defies the post–Cold War triumphalism that predicted the “unabashed victory of economic and political liberalism” around the globe (Fukuyama, 1989, 3). The age of revolution ended in 1989 (Wang, 2009), and the confrontation of the grand ideologies of communism versus capitalism came to a close. But this did not result in the anticipated universalization of the “Western” form of government. It turns out that gradual marketization facilitated China’s economic ascent without leading to wholesale assimilation. The tension between China’s rise and this partial assimilation defines our present moment, and it found its origins in China’s approach to market reforms.

The literature on China’s reforms is large and diverse. The economic policies China has adopted in its transformation from state socialism are well known and researched. Vastly overlooked, however, is the fact that China’s gradual and state-guided marketization was anything but a foregone conclusion or a “natural” choice predetermined by Chinese exceptionalism. In the first decade of “reform and opening up” under Deng Xiaoping (1978–1988), China’s mode of marketization was carved out in a fierce debate. Economists arguing in favor of shock therapy–style liberalization battled over the question of China’s future with those who promoted gradual marketization beginning at the margins of the economic system. Twice, China had everything in place for a “big bang” in price reform. Twice, it ultimately abstained from implementing it.

What was at stake in China’s market reform debate is illustrated by the contrast between China’s rise and Russia’s economic collapse (Nolan, 1995). Shock therapy—the quintessentially neoliberal policy prescript—had been applied in Russia, the other former giant of state socialism (Jessop, 2002, 2018). Nobel Memorial Prize laureate Joseph Stiglitz (2014, 37) attests “a causal link between Russia’s policies and its poor performance”. Russia’s and China’s position in the world economy have been reversed since they implemented different modes of marketization. Russia’s share of world GDP almost halved, from 3.7 percent in 1990

¹ See Weber (2018, 2020) for an in-depth discussion of this point.

to about 2 percent in 2017, while China's share increased close to sixfold, from a mere 2.2 percent to about one-eighth of global output (see Figure 1). Russia underwent dramatic deindustrialization, while China became the proverbial workshop of world capitalism.² The average real income of 99 percent of people in Russia was lower in 2015 than it had been in 1991, whereas in China, despite rapidly rising inequality, the figure more than quadrupled in the same period, surpassing Russia's in 2013 (see Figure 2).³ As a result of shock therapy, Russia experienced a rise in mortality beyond that of any previous peacetime experience of an industrialized country (Notzon et al., 1998).⁴ Given China's low level of development compared with Russia's at the dawn of reform, shock therapy would likely have caused human suffering on an even more extraordinary scale. It would have undermined, if not destroyed, the foundation for China's economic rise. It is hard to imagine what global capitalism would look like today if China had gone down Russia's path.

Despite its momentous consequences, the key role played by economic debate in China's market reforms is largely ignored. The famous Harvard development economist Dani Rodrik represents the economics profession more broadly when he answers his own question whether "anyone [can] name the (Western) economists or the piece of research that played an instrumental role in China's reforms" by claiming that "economic research, at least as conventionally understood" did not play "a significant role" (Rodrik, 2010, p. 34). In the following chapters, I take us back to the 1980s and ask on what intellectual grounds China escaped shock therapy. Revisiting China's market reform debate uncovers the economics of China's rise and the origins of China's state-market relations.

China's deviation from the neoliberal ideal primarily lies not in the size of the Chinese state but in the nature of its economic governance. The neoliberal state is neither small nor weak, but strong (e.g. Bonefeld, 2013, 2017; Davies, 2018; Chang, 2002). Its purpose is to fortify the market. In the most basic terms, this means the protection of free prices as the core economic

² According to the Observatory of Economic Complexity (2018), 75 percent of Russia's exports were mineral products and metals in 2017, whereas China had become the world's largest export economy, mostly thanks to its competitiveness in the manufacturing sector.

³ See Novokmet, Piketty, and Zucman (2017) for a long-term analysis of inequality in Russia as well as a comparison with Eastern European countries and China.

⁴ For studies that link the dramatic fall in life expectancy to the social consequences of shock therapy see, e.g., Leon and Shkolnikov (1998); Murphy, Bobak, Nicholson, Rose, and Marmot (2006); and Stuckler, King, and McKee (2009).

mechanism. In contrast, the Chinese state uses the market as a tool in the pursuit of its larger development goals. As such, it preserves a degree of economic sovereignty that buffers China's economy against the global market—as the 1997 Asian and the 2008 global financial crises forcefully demonstrated. Abolishing this form of “economic insulation” has been a long-standing goal for neoliberals, and our present global governance was designed to put an end to national protection against the global market (Slobodian, 2018, 12). China's escape from shock therapy meant that the state maintained the capacity to insulate the economy's commanding heights—the sectors most essential to economic stability and growth—as it integrated into global capitalism.

To lay the groundwork for my analysis of China's escape, I will first briefly recapitulate the logic of shock therapy.

The Logic of Shock Therapy

Shock therapy was at the heart of the “Washington consensus doctrine of transition” (Stiglitz, 1999, 132) propagated by the Bretton Woods institutions in developing countries, Eastern and Central Europe, and Russia (Amsden, Kochanowicz, and Taylor, 1998; Klein, 2007). On the surface, it was a comprehensive package of policies to be implemented in a single stroke to shock the planned economies into market economies at once (Åslund, 1992; Kornai, 1990; Sachs and Lipton, 1990; Sachs, 1992a, 1992b). The package consisted of (1) liberalization of all prices in one big bang, (2) privatization, (3) trade liberalization, and (4) stabilization, in the form of tight monetary and fiscal policies.

The four measures of shock therapy, implemented simultaneously, should, in theory, form a comprehensive package. A closer analysis reveals that the part of this package that can be implemented in one stroke boils down to a combination of elements (1) and (4): price liberalization complemented with strict austerity.

Lipton and Sachs (1990) spoke for the proponents of shock therapy more broadly when they admitted to complications with regard to the speed of privatization, in practice. They acknowledged the magnitude of the task of privatization in an economy with primarily public ownership. Comparing the large number of state-owned enterprises in the socialist economies with the United Kingdom's privatization record, they pointed out that “Margaret Thatcher,

the world's leading advocate of privatisation" (ibid., 127) had overseen the transfer of just a few dozen state enterprises to the private sector in the course of the 1980s. Hence they observed, "(t)he great conundrum is how to privatize a vast array of firms in a manner that is equitable, swift, politically viable, and likely to create an effective structure of corporate control" (ibid.). They recommended, vaguely, that "privatisation should *probably* be carried out by many means" and the "pace must be rapid, but not reckless" (ibid., 130, emphasis added). The joint report on the *The Economy of the USSR* (1990, 26) likewise cautions against moving too fast with privatization "when relative prices are still unsettled." Similarly, trade liberalization in the eyes of the shock therapists requires domestic price liberalization as its precondition (ibid. 29). A big bang in price liberalization thus emerges as a condition for both privatization and trade liberalization and constitutes the "shock" in shock therapy.

What was presented as a comprehensive reform package turned out to be a policy that is extremely biased toward only one element of a market economy: the market determination of prices. This one-sidedness was not a mere result of feasibility, however. The deeper reason for the bias toward price liberalization lies in the neoclassical concept of the market as a price mechanism that abstracts from institutional realities (Chang, 2002; Stiglitz, 1994, 102, 195, 202, 249–50). In the outlook of neoliberals more broadly, the market is the only way to rationally organize the economy, and its functioning depends on free prices (Weber, 2018; 2020a).

According to the logic of shock therapy as encapsulated, for example, by David Lipton and Jeffrey Sachs, the liberalization of all prices in "one fell swoop" would correct the distorted *relative* prices, which, as a Stalinist heritage, had been too low for heavy industry and capital goods and too high for light industry, services, and consumer goods (Lipton and Sachs 1990, 82). Similarly, the joint report on *The Economy of the USSR* (1990, 25) by the International Monetary Fund, the World Bank, the Organization for Economic Cooperation and Development, and the European Bank for Reconstruction and Development urged,

Nothing will be more important to the achievement of a successful transition to a market economy than the freeing of prices to guide the allocation of resources. Early and comprehensive price decontrol is essential to ending both the shortages and the macroeconomic imbalances that increasingly afflict the economy.

Such wholesale price liberalization would need to be combined with a stabilization policy to

control the *general* price level (ibid., 19). As long as complementary macromeasures were put in place, price liberalization “might lead to a one-time jump in prices, but not to an on-going inflation” (Lipton and Sachs, 1990, 100), the shock therapists alleged. The true causes of persistent inflation in state socialist economies were found to be excess demand due to large budget deficits, the “soft budget constraint,” easy monetary policies, and wage increases resulting from the zero-unemployment policy (Lipton and Sachs 1990, 98). In the shock therapists’ view, these problems could be alleviated by a “strong dose of macroeconomic austerity” since they were, in essence, monetary rather than structural (ibid., 89).

The “one-time jump in prices” expected to result from wholesale price liberalization was welcome since it would “absorb excess liquidity” and, as such, reinforce austerity (IMF et al., 1990, 19, 22). In other words, an increase in the overall price level would devalue the savings and thus reduce the chronic aggregate excess demand experienced in socialist economies. The cost of depriving citizens of the modest wealth they had accumulated under state socialism was considered to be a necessary pain (Reddaway and Glinski, 2001, 179). In effect, it amounted to a regressive redistribution benefiting elites who held nonmonetary assets. Redistribution from the bottom up had been part of shock therapy since its inception in the West German postwar price and currency reform under Ludwig Erhard (Fuhrmann, 2017, 167–70; Weber, 2020b). Forcing market relations on society overnight hinged upon imposing greater inequality.

The nature and structures of the prevailing institutions that would compose the new market economy did not receive much attention from shock therapists. The package recommended by Lipton, Sachs, and many others, including economists based in the socialist world of the time, did not “create” a market economy, as the title of their influential study on Poland suggests (1990). Instead, it was hoped that destruction of the command economy would automatically give rise to a market economy (Burawoy, 1996; Hamm, King, and Stuckler, 2012). It is a recipe for destruction, not construction. Once the planned economy had been “shocked to death,” the “invisible hand” was expected to operate and, in a somewhat miraculous way, allow an effective market economy to emerge. This is a perversion of Adam Smith’s famous metaphor. Smith, a close observer of the industrial revolution unfolding in front of his eyes, saw the human “propensity to truck, barter and exchange one thing for another” as the “principle which gives occasion to the division of labour” (Smith, [1776] 1999,

117), but he immediately cautioned that this principle was “limited by the extent of the market” (ibid., 121). The market, according to Smith, unfolded slowly as the institutions facilitating market exchange were being built up (ibid., 121–6). In this course, the invisible hand could come into play only gradually and, with it, the price mechanism. In contrast, the logic of shock therapy makes us believe that a country can “jump to the market economy” (Sachs, 1994a).

The destruction prescribed by shock therapy does not stop at the economic system. A further condition must be fulfilled: a “revolutionary change in institutions” (Kornai, 1990, 20). Or, as Lipton and Sachs (1990, 87) put it, “(t)he collapse of communist one-party rule was the sine qua non for an effective transition to a market economy.” It did, in fact, require the collapse of the Soviet state and the communist one-party rule in December 1991 before a big bang could be implemented; Russian President Boris Yeltsin eliminated almost all price controls on January 2, 1992. Under General Secretary Mikhail Gorbachev, radical price reform had been repeatedly on the agenda since 1987 but was never carried out, as Russian citizens were complaining en masse and scholars were warning of social unrest. Gorbachev attempted Chinese-style gradualism, albeit in vain (Belik, 1998; Medvedev, 1998; Miller, 2016; Yun, 1998).⁵ With the promise of long-term gain, the big bang prescribed short-term pain that immediately affected the interests of workers and enterprises as well as government departments. Radical price liberalization became politically feasible only after the Soviet state dissolved. “The collapse of communist one-party rule” turned out to be, in fact, “the sine qua non” for a big bang, but the “big bang” failed to achieve “an effective transition to a market economy.” Instead of the predicted one-time increase in the price level, Russia entered a prolonged period of very high inflation, combined with a drop in output followed by low growth rates (see Figure 3).⁶ Almost all of the post-socialist countries that applied some version of shock therapy experienced a deep and prolonged recession (see, e.g., Kornai, 1994; Popov, 2000, 2007; Roland and Verdier, 1999).⁷ Beyond the devastation documented by

⁵ Other cases, such as the German 1948 price and currency reform, the 1948 Dodge Line implemented in Japan, and the numerous cases of similar reform packages applied in the developing world as part of credit conditionalities, also suggest that limited sovereignty might be a precondition for the implementation of these radical measures.

⁶ For a detailed analysis of the implementation and outcomes of shock therapy in Russia, see Kotz and Weir (1997, 161–99). This includes analyses of the economic impacts as well as of the collapse in many indicators of basic human well-being.

⁷ One case that could be considered a challenge to this verdict is Vietnam, which in 1989 imposed a big bang in price liberalization without experiencing hyperinflation or a deep recession (Wood, 1989). Given the predominant evidence from virtually all countries other than Vietnam it is, however, not clear that China could have replicated this result. Vietnam and China are often considered as having had similar starting positions with regard to the level of GDP, industrialization, and the nature of reform up to 1989 (e.g., Popov, 2000, 2007). Two crucial factors set Vietnam and China apart, however: South Vietnam had only become part of the central command economy as recently as 1976, so it began reforming before the new

economic indicators (see above), most measures of human well-being, such as access to education, absence of poverty, and public health, collapsed (European Bank for Reconstruction and Development, 1999; UNICEF, 2001).

Intellectual Foundations of China’s Gradual Marketization and Escape from Shock Therapy

The macroeconomic outcome of China’s market reform policies was the opposite of Russia’s: inflation was low or moderate, but output growth was extremely fast (see Figure 4). Instead of destroying the existing price and planning system in the hope that a market economy would somehow emerge “from the ruins,” China pursued an experimentalist approach that used the given institutional realities to construct a new economic system.⁸ The state gradually re-created markets on the margins of the old system. As I will argue, China’s reforms were gradual—not merely in the matter of pace but also in moving from the margins of the old industrial system toward its core. Unleashing a dynamic of growth and reindustrialization, gradual marketization eventually transformed the whole political economy while the state kept control over the commanding heights. The most prominent manifestation of China’s reform approach is the dual-track price system, which is the opposite of shock therapy. Instead of liberalizing all prices in one big bang, the state initially continued to plan the industrial core of the economy and set the prices of essential goods while the prices of surplus output and nonessential goods were successively liberalized. As a result, prices were gradually determined by the market (see figures 5, 6, and 7).

The dual-track system is not simply a price policy, but rather a process of market creation and regulation through state participation. Before reform, the whole industrial economy was meant to be organized as a single factory with subordinate production units. The dual-track price system transformed the socialist production units into profit-oriented enterprises and created space for burgeoning market relations, with all their social and environmental consequences. The transformation of the economic system was steered at every step by the state. In contrast, big bang price liberalization under shock therapy caused a disorganization of existing

economic model could have been fully institutionalized (Wood, 1989). I will return to the possibility for a big bang price reform in the context of different institutional arrangements with reference to the West German case in Chapter 8. It is also important to keep in mind that, despite a similar initial level of GDP, China’s per capita growth in constant 2010 US dollars consistently outpaced that of Vietnam in the period 1990–2018, at times reaching twice the growth level (World Bank, 2019).
⁸ See Naughton (1995) for a detailed account of how China grew out of the plan.

production links without replacing them with market relations. In this void, neither the old command structures nor the market operated effectively (Burawoy, 1996; Hamm et al., 2012; Roland and Verdier, 1999).

By the end of the 1970s, China had given up on the revolutionary ambitions of late Maoism. The defining question of the 1980s was not whether to reform—as the commonly invoked binary of conservatives versus reformers stresses. The question was *how* to reform: by destroying the old system or by growing the new system from the old. To use a metaphor, if shock therapy proposed to tear down the whole house and build a new one from scratch, the Chinese reform proceeded like the game of Jenga: only those blocks were removed that could be flexibly rearranged without endangering the stability of the building as a whole. Yet, through this process, the building was fundamentally changed. As everyone who has played Jenga knows, certain blocks may not be removed lest the tower collapses. China almost implemented such a destructive move by prematurely scrapping essential price controls in the critical first reform decade (1978–1988). But it ultimately abstained. The gradualist reform that set China on a path of catching up, reindustrializing, and reintegrating into global capitalism also implied that the institutional convergence between China and the neoliberal variety of capitalism remained incomplete. Like in the game of Jenga, the new tower was shaped by the structures of the old. As such, an escape from shock therapy was critical for both China’s economic rise and its partial institutional assimilation.

Shock therapy is underpinned by neoclassical economics that constituted an intellectual bridge between mainstream economists in the West and market socialists in the East (Bockman, 2011; 2012). In contrast, we know little about the economics that provided China an escape from shock therapy—the economics of China’s gradual marketization. In this book, I offer an historical and analytical account of China’s 1980s market reform debate and show how the dual-track system was theorized, contested, and defended against shock therapy.

Approach of the Book

My aim is to analyze the intellectual struggle between those reform economists who pursued the logic of shock therapy and those who argued for experimental gradualism and the dual-track price system. As such, this book is complementary to Keyser’s (2003) *Professionalizing*

Research in Post-Mao China and Gewirtz's (2017) *Unlikely Partners*. Both books are primarily concerned with the formation of one or the other of these two intellectual strands in the 1980s, and they focus more on networks and knowledge exchanges than on an in-depth engagement with the economic arguments pronounced in China's market reform debate.⁹ The study of economic discourse in China had fallen out of fashion in the English-language literature and is currently experiencing something of a revival (see, e.g., Brødsgaard and Rutten, 2017, 1; Cohn, 2017; Karl, 2017; Liu, 2010; Zhang, 2017). My work has benefited from these recent contributions as well as from earlier accounts of the history of economic reform in 1980s China (e.g. Fewsmith, 1994; Halpern, 1985, 1986, 1988; Hsu, 1991; Naughton, 1995; Shirk, 1993).

Hsu (1991) offers the most extensive review of the substance of economic theorizing in the course of China's 1980s reform. But as Halpern (1993, 267) observes, Hsu "set out to explain to himself why ... Chinese economic journals in the late 1970s and early 1980s published so many dogmatic and superficial articles." Hsu thus argues from the standpoint of the superiority of Western mainstream economics rather than trying to understand the ways in which Chinese economists theorized the problems they sought to tackle. In contrast, I aim to analyze the different voices of reform in China on their own terms, to engage in depth with the substance, origins, and underlying logic of the economic arguments presented by competing reform economists—while also situating these arguments in their relevant context. I focus on one central issue in reform: the decisive question of price reform and market creation. Yet, in carving out the different positions on this major issue in economic reform, a broader confrontation between fundamentally opposed approaches to economic policy and doing economics becomes apparent—one that underpins shock therapy on the one hand and gradual marketization on the other.

This book is the perspective of an outsider looking back in history at China's market reform debate, rather than the account of a participant. This sets my work apart from firsthand accounts of the Chinese reform debate of the 1980s, such as those of Chen Yizi (2013); Dong Fureng (1986); He Weiling (2015); Hua Sheng, Zhang Xuejun, and Luo Xiaopeng (1993); Peter Nolan and Dong Fureng (1990); Lim (2008, 2014); Lu Mai and Feng Mingliang (2012); Sun

⁹ See my review of Gewirtz for a more detailed analysis (Weber, 2019a).

Faming (2011); Wang Xiaoqiang (1998); Wang Xiaolu (2019); Wu Jinglian (2012, 2013); Wu and Fan (2012); Wu and Ma (2016); and Zhu Jiaming (2013). All these accounts were invaluable references.

This book is based on a wide range of Chinese published and unpublished primary sources and oral history interviews with economists who participated in or witnessed China's 1980s market reform debate. (See the Bibliography for the full list of interviews.) I asked open-ended questions tailored to the interviewees' specific positions and involvement in the making of reform policies. The goal was to bring out the speakers' views on the course of reform rather than to impose a preconceived structure. I conducted most of the conversations in Chinese. The speakers provided documents and publications that form important sources. Interviewees were identified and approached based on the principle of snowballing. Beyond direct references to these interviews throughout the book, my own thinking and analysis of China's first decade of reform has been shaped by the diverse perspectives and competing interpretations presented by my interviewees. The Chinese articles from the 1980s analyzed in detail in this work were selected based on evaluations by the interviewees, who believed these publications to have set the tone of the debate and to have been considered by the Chinese leadership who pondered the question of market reform.

The interviews were the key event in my intellectual journey in trying to understand how China escaped shock therapy. To unpack the larger relevance of the insights derived from these conversations and from primary sources, Part I of the book takes a step back and situates this material in a broader context of relevant historical modes of market creation.

To conceptualize the state-market relation emerging in the dual-track system, I propose a *longue durée* perspective that acknowledges China's distinct institutional legacy of price regulation through state participation in the market (Chapter 1). My purpose is not to suggest any sort of monolithic continuity or even a linear development from ancient times to the crossroads of the 1980s. Instead, I use these traditional concepts of price regulation and market creation as a novel analytical perspective to shed light on China's 1980s debate. Far from essentializing China's reform as predetermined by the nature of its society or culture, I show that China's reform approach was the result of genuine intellectual struggles. This

intellectual contest resonated with debates over the right handling of the market by the state that reoccurred throughout Chinese history.

I do not propose to posit China against the West, or Chinese economics against Western economics. Instead, I suggest that an approach to economics—an approach that was more inductive, institutionalist, and pragmatic than that of neoclassicism—was fiercely contested but turned out to be dominant at the critical juncture of China’s first decade of reform. This kind of economics is by no means unique to China. This fact is illustrated in the book through my analysis of debates over postwar market creations in the United States, the United Kingdom, and West Germany (Chapter 2). My interviewees repeatedly made references to the postwar experiences in these countries. The transition from a planned war economy to a market economy posed challenges similar to those later encountered in the transition from socialism. American and European economists fiercely debated the question of how to deregulate prices and re-create markets after the war. The so-called “Erhard Miracle” that followed the West German wholesale price liberalization provided an important piece of anecdotal evidence in favor of shock therapy in China’s reform debate (Weber, 2019b, 2020b). Some prominent institutionalist economists, such as James Galbraith in the United States and Alec Cairncross in the United Kingdom, argued for a gradual decontrol with some similarity with China’s market reforms. Both Cairncross and Galbraith came to be important references for China’s gradualist reformers.

In Chapter 3, I introduce an experience of market creation more immediately connected with the 1980s reform debate: the Communists’ 1940s fight for price stabilization. Unlike the ancient concepts of price regulation through market participation, the 1940s experience exerted a direct and explicit influence on the ways in which Chinese economists and reformers have thought about market creation in the reform era. Many of China’s most prominent reform leaders and economists of the 1980s participated in the revolutionary war. Overcoming hyperinflation and reintegrating the economy was key to the material base of the Communists’ revolutionary struggle. The Communists employed a strategy of economic warfare that relied on re-creating markets through state commerce in order to reestablish the value of money. The techniques of economic warfare resembled elements of the traditional practice of price regulation and were revived in the early stages of economic reform in the 1980s as part of the efforts toward gradual marketization.

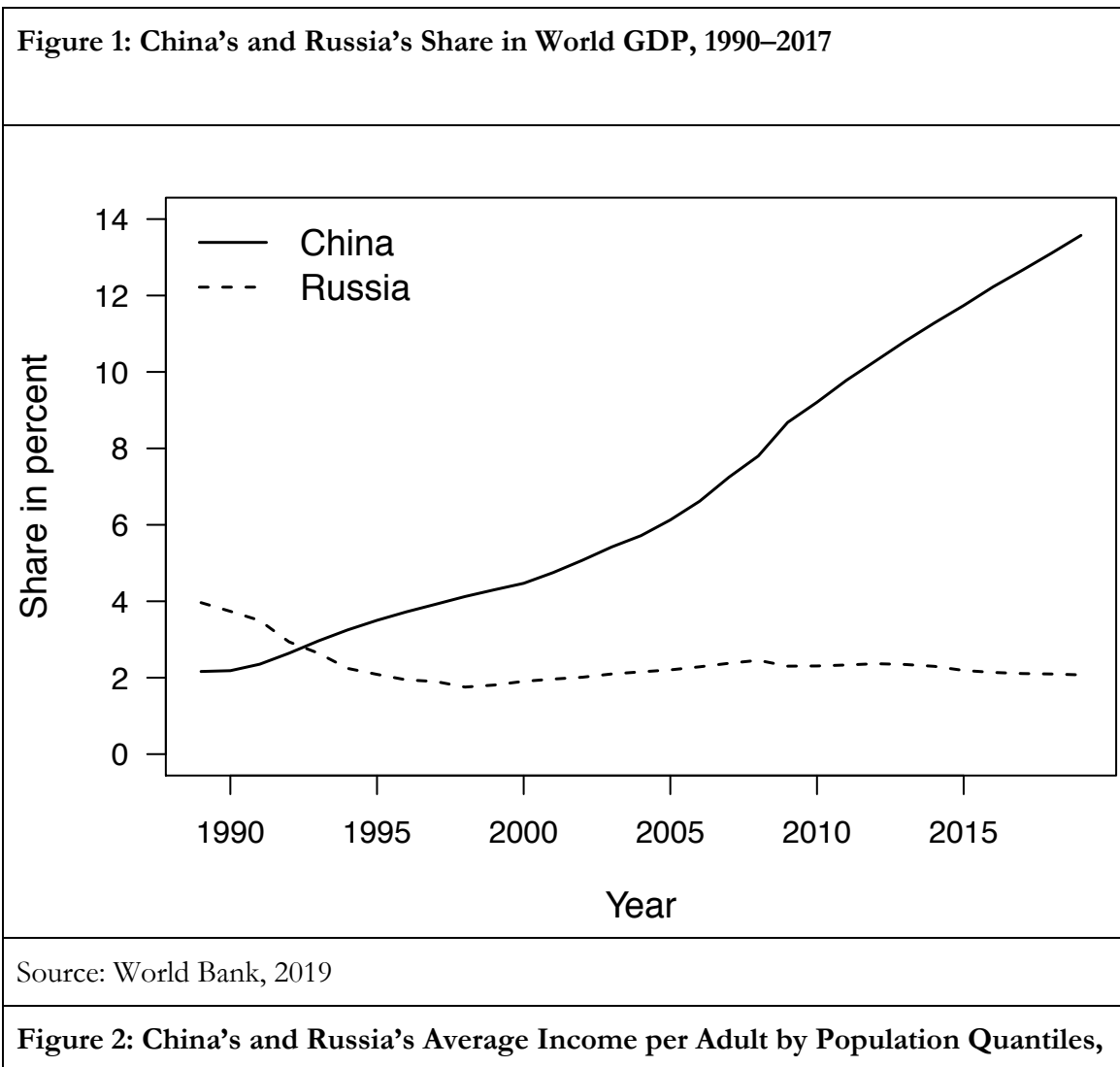
Building on my discussion of modes of market creation, the second part of the book presents an in-depth analysis of China's 1980s market reform debate. I set the stage with an overview of the Mao-era development model and price system to show the challenge of introducing market mechanisms. To equip readers with an understanding of the point of departure for the debate, I examine why China turned to reform in the late 1970s. I derive how a reorientation away from the late Maoist ideal of continuous revolution to economic progress as the all-encompassing goal of reform led to the reinstatement of economics after the discipline had been banned as a bourgeois project during the Cultural Revolution (Chapter 4). Chapter 5 dives into the early stages of China's market reform debate. It traces the intellectual origins of wholesale price liberalization, locating them in exchanges between China's established academic economists and Eastern European émigré economists, the World Bank, and other foreign visitors, including Milton Friedman. This reform approach closely resembled the logic of shock therapy and came to be called "package reform" in the Chinese debate. As in other contexts, it was grounded in neoclassical economics, both the neoliberal and the socialist types. Chapter 6 contrasts package reform with the outlook of young intellectuals and older officials who formed an alliance as a result of their shared concern for rural reform. This alliance played a key role in researching, theorizing, and defending the gradual marketization from the margins that emerged from on-the-ground experimentations. This approach employed an interdisciplinary, institutionalist, and inductive kind of economics that utilized methods from the social sciences.

Chapters 7 and 8 show how these two reform approaches—wholesale liberalization versus marketization from the margins—clashed when China escaped shock therapy. In 1986, Premier Zhao Ziyang was convinced by gradualist reform economists who debunked the idea of a big bang to withdraw his initiative for wholesale liberalization. In 1988, Deng Xiaoping personally called for a big bang. His plans were reversed when, in the summer of that year, China experienced the first episode of runaway inflation since the 1940s. Deng was prepared to push ahead with full-scale marketization but not at the cost of undermining the ability of the state to maintain control over society and the economy.

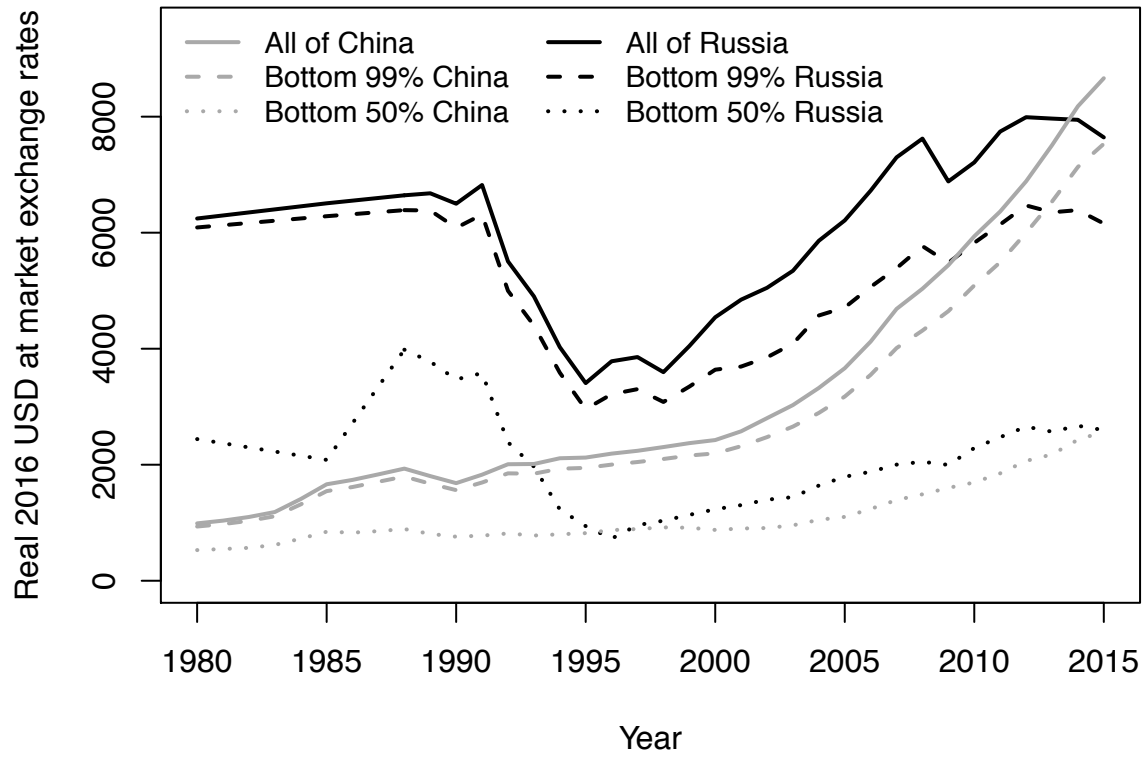
In 1988, China escaped shock therapy a second time. At this point, market reforms had already unleashed rapidly increasing inequalities and flourishing corruption. The "golden age of reform" of the first years, when everyone seemed to be benefitting equally, was fading. In

1988, the prospect of a further radicalization of market reforms shook the foundations of Chinese society. The 1989 social movement ended with the crackdown on Tiananmen Square. Reform came to a temporary halt. When China restarted marketization in 1992, the shock therapy agenda had by no means disappeared. On the contrary, the 1990s saw major victories for neoliberals in China. Yet the basic mode of gradual, experimentalist marketization had been set in the 1980s. Although it was renegotiated, challenged, and amended in the subsequent decades, it was not overturned.

Appendix

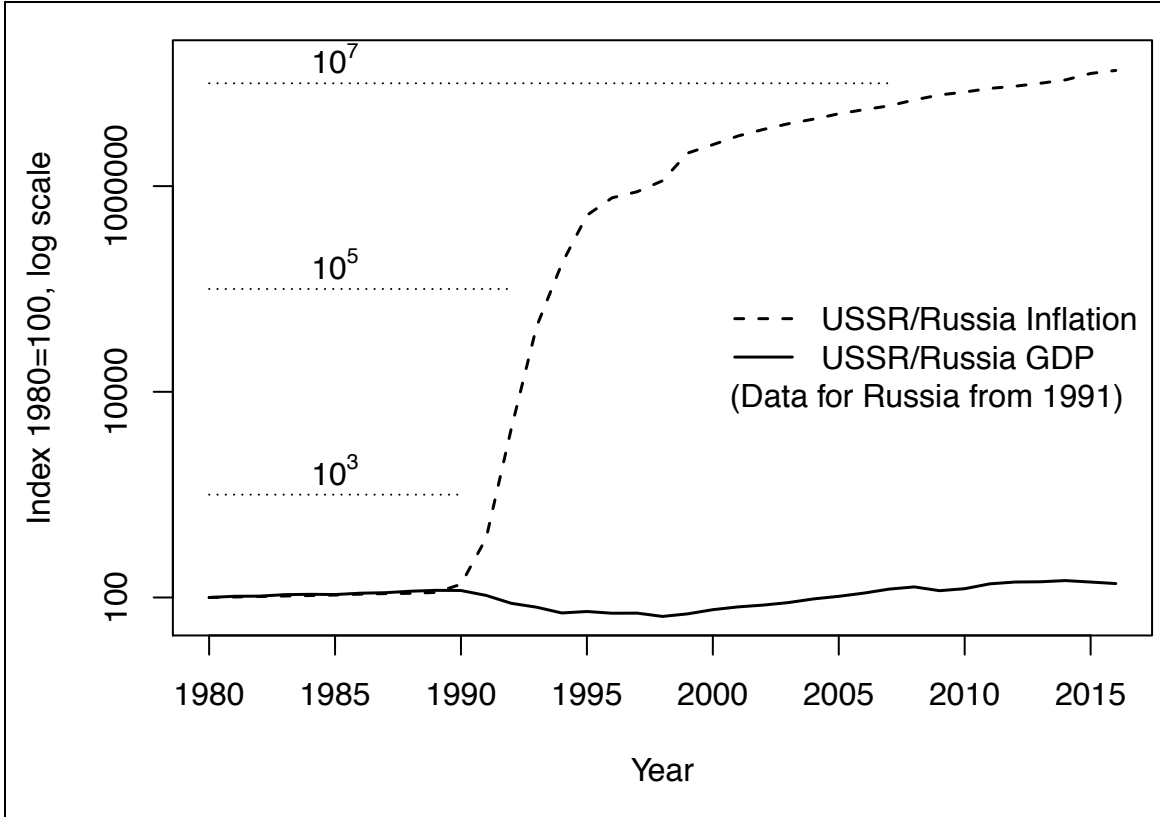


1980–2015



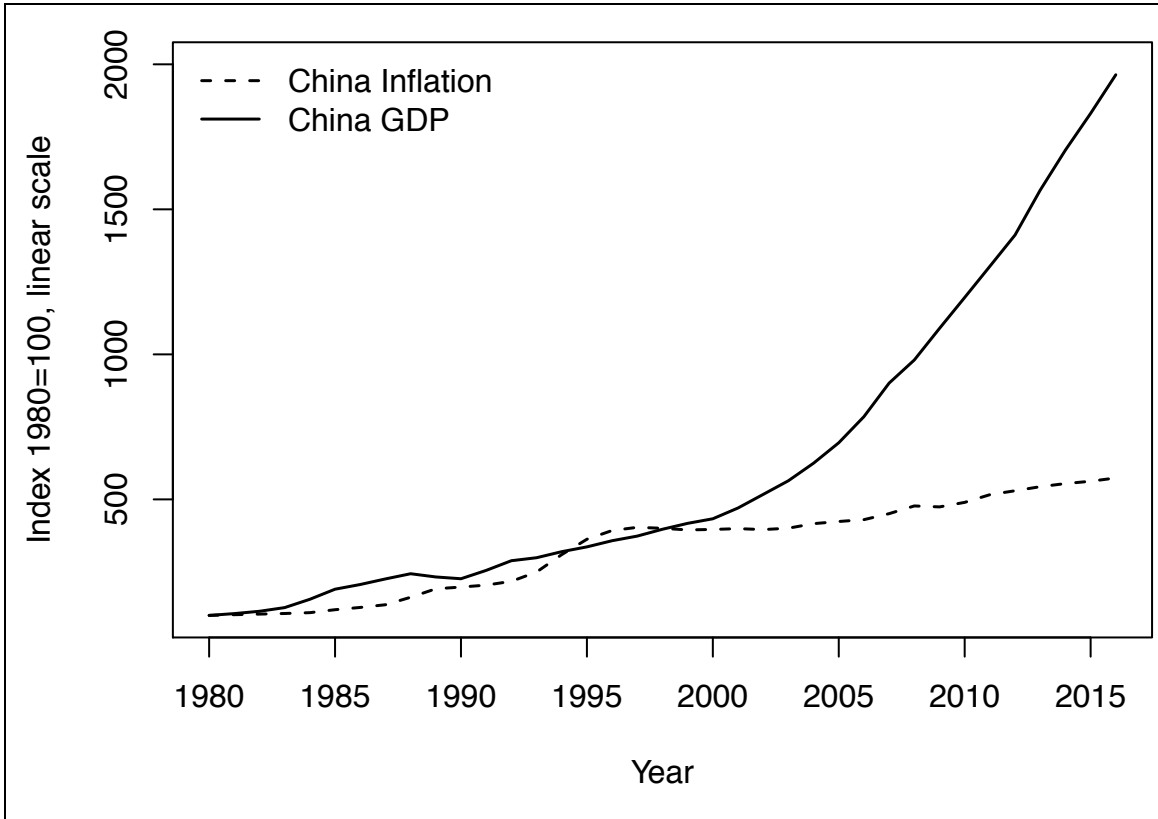
Source: Alvaredo et al., 2017

Figure 3: USSR and Russia (from 1990) Consumer Price Index and Real GDP, 1980–2016



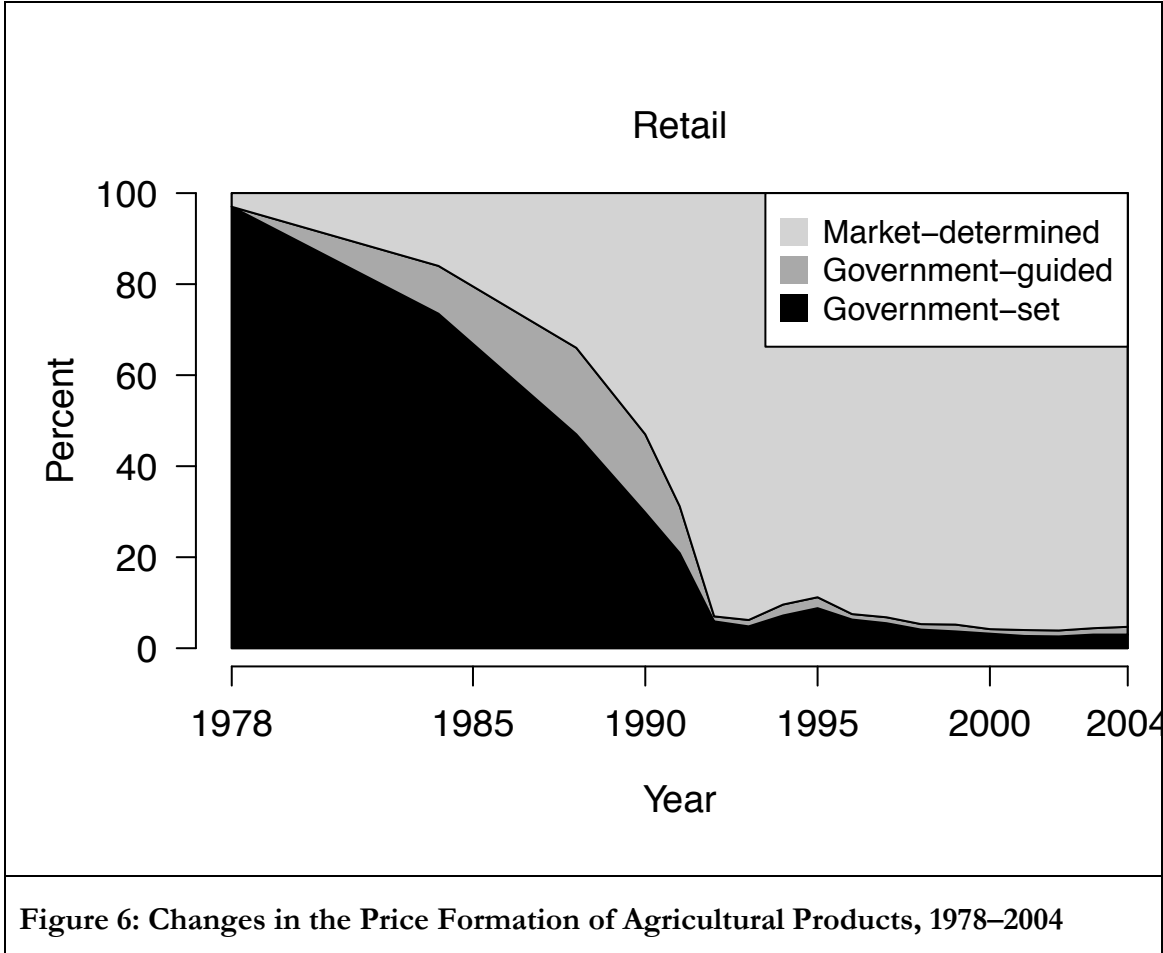
Sources: CPI USSR, 1971–1990 (IMF et al., 1991, 100); CPI Russia, 1991 (Filatochev, Bradshaw, and Bradshaw, 1992, 746), 1992 (Sachs, 1994b, 70), 1993–2016 (IMF, 2017); GDP (Alvaredo et al., 2017)

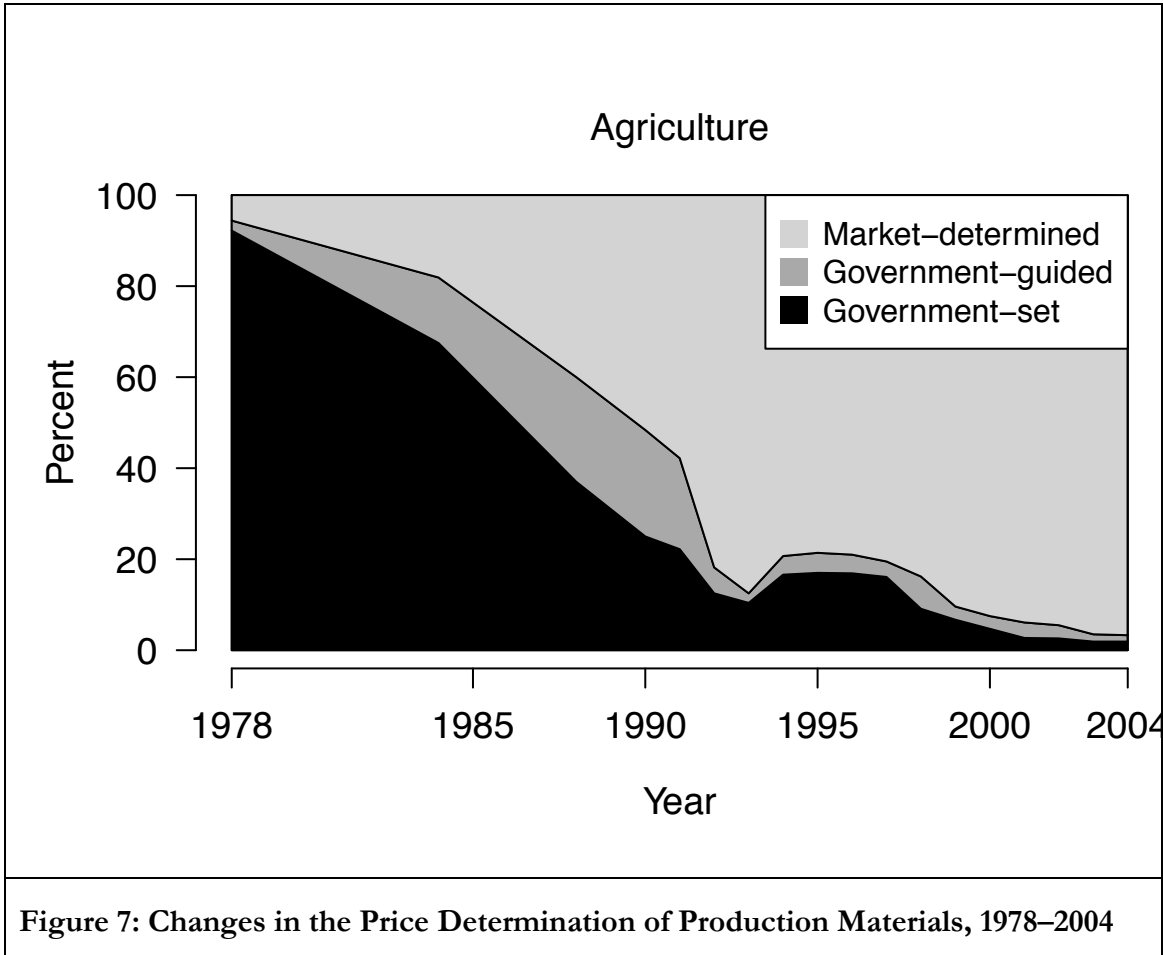
Figure 4: China CPI and Real GDP, 1980–2016

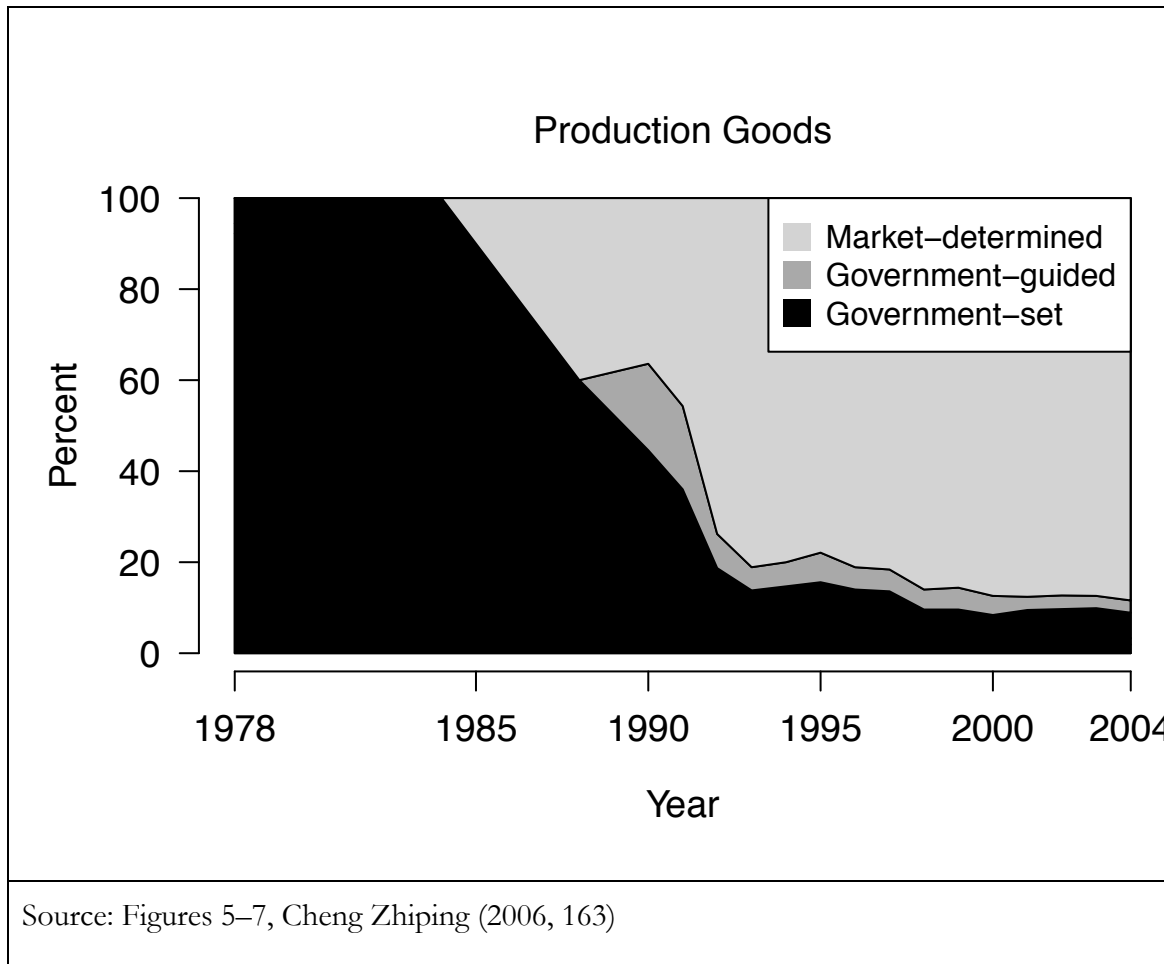


Sources: CPI (IMF, 2017); GDP (Alvaredo et al., 2017)

Figure 5: Changes in the Price Determination of Retail Products, 1978–2004







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Conclusion

*Wanderer, your footprints are
the path, and nothing else;
wanderer, there is no path,
the path is made by walking.*

Antonio Machado

The economic transformation China experienced during its period of reform beginning in 1978 was inconceivable at its outset. The country's historic economic growth in the decades of neoliberal globalization stands in sharp contrast with the fate of most economies in the global south. In the period 1950 to 1980, most developing economies enjoyed high rates of economic growth, outpacing China's. But their relative standing has been turned upside down in the decades since (Amsden, 2007, 6-7). In the 1980s, most African countries endured negative GDP growth, while in Latin America, the golden age of industrialization gave way to 25 years after 1980 of only 10 percent cumulative growth. By comparison, in the first two decades of reform, China's economy grew annually, on average, more than Latin America's had over a quarter of a century (ibid.). Although the East Asian "tigers" and India fared far better than the rest of the world, China's average annual growth rate of more than 10 percent stands at double that of these other high-performing countries. With the benefit of hindsight, we now know that China was, in the late 1970s, on the cusp of an economic expansion often described as unprecedented in scope, pace, and scale—just as the developing world as a whole was falling behind.

GDP growth is, of course, a crude indicator. However, it does provide an approximate measure of the changing position of a given country in relation to the world economy. When China's economists returned to Beijing after the Cultural Revolution to join the reform effort, China was poor and attempting to carve out a path toward economic prosperity. The ambition of continuous revolution under Maoism was replaced by an all-encompassing primacy of economic development.

China's rise is now a fact of life. From the vantage of the struggles among China's economists over the right reform path, this historic outcome was a daring hope, if not altogether implausible. When young reform intellectuals returned to Beijing after years in remote villages and flocked to empty lecture halls to discuss China's future, the explosive growth of subsequent decades—albeit with all its severe social and environmental consequences—was unimaginable. In their study exchanges on economic system reform with Eastern European émigré economists and with World Bank and other international dignitaries, the economists of China's revolutionary generation and its establishment intellectuals could only marvel at the prosperity and advanced state of the applied sciences abroad. The System Reform Institute's delegations toured Hungary, Yugoslavia, Brazil, and other Latin American countries, in the

hope of learning from the achievements (as well as mistakes) of what were then model national economies for China.

What was at stake in China's reform debate of the 1980s was nothing less than a common understanding of the economy's basic mechanisms. Early on, the dominant position within the Chinese economic intelligentsia reflected the view that market forces had to play a greater role in society and that this would necessitate price reform. Fundamental disagreements arose among China's economists around the question of *how* such reform would take place but not about *whether* to pursue marketization. Competing reform approaches expressed themselves in the disagreements over the continued use of the dual-track price system and mobilization of existing institutions to create markets; this was countered by some with a strategy of shock, in which the economy was to be subjected to wholesale and sudden liberalization. The fact that the two sides clashed over this next step of reform rather than over the economy's basic direction might suggest that its focus was highly technical, without deeper ideological significance. In fact, as in the Soviet industrialization debate of the 1920s—the focus of which was also the speed and pattern of development, but not the retreat from War Communism to the New Economic Policy *per se*—“the basic differences between two ideological tournaments became visible” (Erllich, 1967, xvii). Such differences manifested themselves in two different approaches to the economics of reform.

China's reform economists shared one common goal above all others: economic progress. They also agreed that marketization would be necessary in pursuit of economic development. But the two basic schools of thought clashed over how to move forward. One position was in accordance with what came to be known as the shock therapy doctrine of transition—a quintessentially neoliberal policy prescript that swept the socialist world (see the Introduction). This side held that the desired economic model would be posed axiomatically and that a shock to the old system would transform it in one go. This approach assumed that the most desirable future model as well as the means of establishing it could be derived from economic models. According to this view, a blueprint was to be drawn up to map a comprehensive package of measures that would redesign the entire system according to one unified concept. The alternative school of thought, by contrast, acknowledged an essential ignorance of both the end—the ultimate condition of the Chinese economy—as well as the path to get there. This second vision took as a basic premise the absence of any blueprint or comprehensive plan that

could deliver a general answer to the challenge of reform. From this viewpoint, the mechanism of reform and the specifics of the new system had to be worked out through experimentation and theoretically guided empirical research. From this latter perspective, there was simply no way to divine China's future on a drawing board. "Armchair economics" was deemed to fail. In the following sections, I recapitulate the core reform prescriptions of these two competing approaches.

The Idealism of Package Reform

The Chinese proponents of a so-called package reform, like the shock therapists around the world (see the Introduction), promoted an initial "big bang" in price reform. The package was to include price adjustments, in one step, for critical producer goods such as raw materials and energy, followed by liberalization. The package reformers' basic approach was to begin by choosing a target model for reform and to contrast this ideal target model with a schematic version of the old command economy. In the ideal target model, the market mechanism was carried out primarily through flexible prices. One of the fundamental differences between the desired target and the old system was a lack of price flexibility in the latter. These reformers located the most severe price distortions in the producer goods sector, which were traditionally priced low in the Soviet approach to development. The most effective approach to reform, in their view, would require first tackling these exaggerated deviations from the target model, overcoming the distortions in the prices of raw materials and energy simultaneously. Such a dramatic step in reform had to be prepared, however, by first "cooling" the economy. This meant, in practice, enforcing harsh austerity with the aim of overcoming macroeconomic imbalances.

The package approach to reform held that the coexistence of the obsolete old and the desired new systems would create harmful frictions, resulting in the ineffectiveness of both the old and the new regulating mechanisms. From the vantage of package reformers, the dual-track price system was at best acceptable as a temporary, transitory measure, but it had to be overcome as quickly as possible. The big bang proponents invoked an argument structurally similar to Hayek's warning of the "slippery slope" toward a planned economy that might result from any move in favor of price controls (see Chapter 2). In their eyes, if the dual-track price system prevailed, along with the confusion and corruption they attributed to it, the result

would be a harmful reversal. As long as core elements of the old system persisted—such as central control over the prices of crucial producer goods—the possibility of a relapse would be ever present. They thus recommended that the price system be introduced rapidly and universally, arguing that only the destruction of the core of the old system could realize the target model. They acknowledged that this approach would cause short-term pain. But in their eyes, the only alternative was long-term suffering.

The proponents of such radical price reform recognized that their proposal entailed one grave risk, namely an increase in the general price level. However, as with Friedman's (1966, 20) metaphor of the overfueled furnace that can be defused only by letting all its heat out at once (see Chapter 2), they argued that suppressed inflation could not be overcome unless direct price controls were removed. As a necessary evil, they argued, it would be better to get on with it without delay. As Brus put it, "the day of reckoning" would arrive eventually, and so it would be better to confront and overcome its challenges sooner rather than later (see Chapter 5). As long as tight fiscal and monetary controls were in place, a one-time increase in prices to compensate for suppressed inflation would not detonate an ongoing inflationary process. To return to Friedman's metaphor: the overfueled furnace, having released its heat, would exhaust itself. As with the pain accompanying surgery, removing price controls was therapeutically necessary and temporary. Seen from this perspective, inflation was a monetary, not structural, phenomenon and could be controlled by the government; aggregate excess demand was only the result of the pathologies of socialism. Such thinking is best captured by concepts such as Kornai's "investment hunger" and "soft budget constraint" (see Chapter 7) —which do not concern themselves with the challenges of industrialization. In this view, the Chinese inflation of 1988 was the result of the government's failure to impose sufficiently strict macro controls and not the consequence of Deng Xiaoping's failed attempt at shock therapy (see Chapter 8).

As I explored in greater detail in chapters 4, 5 and 6, the package reformers found principal sources of inspiration for their theories in Eastern European émigré economists who had abandoned market socialism, neoclassical mainstream economics, the central figures of monetarism, and, for the younger generation, increasingly in concepts of optimal design and control from engineering.¹⁰ Most of the package reformers were academic economists, and

¹⁰ This finding is consistent with Bockman (2012; 2011) and Bockman and Eyal (2002), who have shown the roots of neoliberal transition in neoclassical socialist economics.

many had been adherents to Soviet orthodoxy in the early years of the People's Republic. In fact, we may observe a parallel between the idealization of the planned economy in Soviet Marxism, where the whole national economy was imagined to function as one centrally planned factory, and the idealization of a market economy underlying the shock therapy approach. While the two theoretical approaches oppose one another on the question of the superiority of a plan or a market as a regulating mechanism, they are united in striving for an optimal, rational economy. This methodological commonality between those believing in the omnipotent power of the visible and the invisible hands was observed by one of the foremost general equilibrium theorists, Frank Hahn (1981, 2):

[Both sides] take it for granted that somewhere there is a theory, that is a body of logically connected propositions based on postulates not wildly at variance with what is the case, which support their policies.

This quest for representing the whole economy in one closed model was also a common ground between the planning and the market proponents of the Socialist Calculation Debate. From the technocratic stance of both sides, the economic problem boils down to finding a set of rational prices. Or, as Paul Samuelson (as in Foley, 2011) observed,

[I]t doesn't really matter whether capital hires labor or labor hires capital, or both are allocated by a central planner: the important goal is the allocation of productive resources and final products consistently with the principle of equating marginal cost and marginal benefit.

The Chinese package reformers adhered to the same kind of economics. They saw the task of market creation as drawing up a comprehensive policy blueprint that had to ensure, first and foremost, rational prices. From the reformers' perspective, rational prices could be achieved only by applying either the market or the plan as a pure form, and the dual-track price system was condemned as an incoherent hybrid. Whereas a multitrack price system had been used to overcome hyperinflation after the civil war, the subsequent pursuit of Soviet-style planning involved the ambition to suppress price tracks other than planned prices, at least for important goods (see chapters 3 and 4). The dual-track price system would be an unavoidable evil over the course of the market transition, but it was to be abolished as soon as possible. At the outset of reforms, package reformers saw the task before them as precisely the opposite of that from the days when China had emulated the Soviet model. Now, all prices should be unified under the market track.

Resemblances between the paradigms of pure market orthodoxy and pure planning can also be detected in the concrete steps suggested by the Program Office in 1986, with the aim of generating a breakthrough in China's price reform. According to the 1986 agenda, prices would first be unified into planned equilibrium prices determined by calculation, after which they would be fully liberalized. This reform proposal assumed that both calculation and the forces of the market would bring about the same, or at least sufficiently similar, equilibrium prices. Thus, calculation-based planning and the market were taken to be means to the same end. As with Hayek's and Robbins's judgments in the Socialist Calculation Debate,¹¹ the problem presented by calculating prices within the logic of the Program Office approach was that it was too time-consuming to be practical as a sustainable form of regulation. Nevertheless, the Program Office economists believed calculation from the center could prepare the wholesale transition to a superior market mechanism. Market determination of crucial input prices, from this point of view, did not require a process of institution building. As the *natural* order of things, market prices were expected to emerge instantly and spontaneously once the *artificially* imposed control over prices was removed. Instead of envisioning a slow, historical evolution toward a new political economy, shock therapy suggested a rapid move into an ideal market, following planned steps from the theoretically derived blueprint.

In this regard, the so-called "Erhard Miracle" was invoked as anecdotal evidence for the practicality of the theory. However, proponents of emulating the West German example did not analyze in any great depth the actual economic history of Erhard's price and currency reforms or whether, indeed, these policies were suitable for addressing the challenges China confronted in the 1980s. Rather, they subscribed to the neoliberal mystification of Erhard's price reform and saw it as a "miracle" (Weber, 2020). Similarly, they cited the supposed lesson of Eastern Europe—that gradualism would fail. They relied on the authority of famous economists. Systematic historical inquiry, however, might have posed the question of why attempts at overnight price liberalization in Eastern Europe repeatedly provoked social and

¹¹ Hayek (1935a, b) and Robbins (1934) retreated from von Mises's claim of the impossibility of a rational socialist economy to a "second line of defense" (Lange 1936, 36). They did not deny the *theoretical* possibility of a rational allocation of resources in a planned economy. But they doubted the possibility of a satisfactory *practical* solution to the problem.

political turmoil and were ultimately (partially) reversed. This history, in any case, had been well known in China since the Moganshan World Bank conference of 1982, if not earlier (see Chapter 5).

As for their idealism, those academic economists in favor of a comprehensive reform package showed some striking resemblance to the scholar officials in the *Salt and Iron Debate*, despite the radically different contexts and the two millennia that separated them. The scholars of the ancient debate began from a vision of an ideal state in the past, which they aimed to reinstate, rather than from the specific challenges facing the new emperor in the context of a deep economic crisis (see Chapter 1). The ancients held that if the ritual order and righteousness were to be reestablished, the state could withdraw from direct intervention into the economy—in particular, from controlling salt and iron monopolies, as well as from regulating prices of essential agricultural products by dampening the supply and demand fluctuations. As long as morality ruled, they believed, the state’s interventions could remain minimal, and the retreat of bureaucrats from economic activities would guard against corruption. The big bang proponents of the 1980s also advanced an argument about the state’s withdrawal from the economy; they saw the state’s role as a market player under the dual-track price system as the main source of corruption. They too envisioned a minimalist state that would regulate society indirectly by macroeconomic means and rule-setting rather than through righteousness. Here, the parallels end. In sharp contrast with the ancients, reformers held that morality was to be replaced by free competition among individuals. Left to develop spontaneously on its own, this competition would translate the pursuit of self-interest into the best outcome for society. The ancient scholar officials held that markets were to be subordinate to the moral order of society. For the shock therapists, all realms of society were to be subordinate to a universal market.

The Pragmatism of Dual-Track Reformers

Just as in the ancient *Salt and Iron Debate*, practically minded scholars and commerce officials challenged the idealist approach in China’s price reform debate of the 1980s (see chapters 5 through 8). Rather than aiming to move toward a theoretically derived target model in one push, they conducted in-depth empirical research guided by theorizing but unconstrained by the quest for one all-encompassing model of the economy. Their aim was to discover a means

for the gradual improvement of China's economy and to examine the place of markets in this endeavor—not to project an ideal future state. Dual-track reformers took an approach that identified and harnessed transformative forces already emerging in prevailing commercial and industrial activity. With regard to price reform, this meant an imperative to improve the dual-track price system rather than destroy it. In their analysis, wholesale liberalization could not solve the problems of China's price system. Investigations using a large sample of Chinese state-owned enterprises (SOEs), as well as a survey of the Yugoslavian and Hungarian reform experience, for example, indicated that a big bang would result in a reversion to the initial relative prices instead of the sought-after adjustment of the price structure.

Closer scrutiny of the postwar West German transition amplified the gradualists' skepticism about reproducing an "Erhard Miracle" in China, as the big bang was dubbed. The mere removal of price controls could not transform the SOEs into market enterprises. They remained socialist production units insofar that they had no power over the magnitude of capital and labor they employed. Workers could not be fired, and SOEs did not draw upon any capital market; they were forbidden from going bankrupt. The SOEs had no choice but to use their monopolistic position and to carry on, no matter the circumstances. According to the logic of the big bang, an increased input price should have induced adjustments in production technology or even have arrested the production of certain goods. But in reality, the SOEs could only react to input price increases by passing them on to producers further along in the production chain. The result would thus ultimately be consumer price inflation, which would in turn fuel wage increases. The opponents of a big bang predicted that shock therapy would generate runaway inflation rather than a convergence at some desired equilibrium. The outcome would be destruction of the core of the old economy, without creating a functional market economy. Such a development would put China's social and political stability at risk and thus endanger the project of reform altogether.

The defenders of the dual-track price system predicted that the prescription of rapid price liberalization would lead to failure, even on its own terms. In their view, neither pure central control nor overnight liberalization could address the challenge of catching up with the advanced capitalist world and increasing overall living standards. They did not infer from this that there was no prospect for reform, however. Rather, the gradualists suggested that the prevailing system of multiple prices—along with certain practical adjustments—was well

suiting for gradually transforming both China's price structure and its price-determining system and, with it, the economy's regulating mechanism at large.

In the view of the gradualist experimentalists, market determination of prices was not achieved simply by abolishing price controls. The gradualists contended that the manner in which prices are determined depended on the mode of operation at the micro level. In a similar vein, inflation was not understood as a purely monetary phenomenon, especially under conditions such as China's. From the viewpoint of these pragmatic economists, familiar as they were with the living conditions of the overwhelmingly rural population of China, aggregate access demand was not to be achieved by suppressing demand, but rather by boosting supply. For the dual-track defenders, the challenge facing the Chinese economy was to be understood as a "reindustrialization." Reindustrialization required overcoming certain bottlenecks, for example, in critical producer goods and in energy, by increasing production but not by raising prices. The process was complex and required delicate intervention. It could not be accomplished in a single blunt act. China's revolutionary history had shown that industrialization could not be attained simply by state command. The gradualist reformers argued that faith in a market miracle was likewise a delusion. The only sensible approach, they said, was a gradual, experimental one in which market forces would be created and harnessed by the state in a controlled manner. In their eyes, the dual-track price system, which had emerged from bureaucratic practice and the experience of rural reform, was well suited to achieve this and could be expanded to apply to critical producer goods such as steel and coal.

The essence of the dual-track price system can be captured by the perspective of the Guanzian principle of controlling the "heavy," or essential, and letting go of the "light," or unimportant (see Chapter 1). It is critical to understand that the relative importance of commodities was determined not only by their physical characteristics but also by the specific local conditions of their markets and social contexts of their production. What was determinative was whether a good was the product of a major, centrally controlled production facility or the productive efforts of a minor local enterprise. Even within the output of one major producer, the state-mandated quota was important for keeping the core of the industrial economy running. Surplus production, by contrast, could be left to the discretion of the enterprise. The basic principle of the dual-track price system therefore was to relinquish the price controls of inessential goods produced by minor suppliers. It also relinquished the price controls on

surplus product of major producers of essential industrial inputs such as raw materials and energy. The system of material balancing along with planned prices thus was initially kept intact. At the same time, the high prices of surplus products of scarce raw materials and energy marketed to producers outside the industrial command system—such as township and village enterprises (TVEs) as well as other SOEs—produced strong incentives for the enterprises to economize their planned production and to squeeze out a surplus for the market. In this way, the SOEs grew into the market as the industrial core of the Chinese economy was marketized. The state commercial system, too, was not abolished but was used to integrate the national market and balance prices across regions.

Exactly who is to be credited as the originator of the dual-track price system remains a matter of dispute. I have argued throughout the second part of this book that the reform mechanism was not, in fact, invented by any single individual. Rather, the dual-track price system emerged through the gradual relaxation of control in the areas most peripheral for the functioning of the industrial economy. Such a relaxation of controls was achieved by careful experimentation, followed by systematic evaluation of this practice through empirical research. The structure of gradual price releases thereby reflected the logic of the Maoist price system, under which the most essential prices for industrialization and livelihood were the most tightly controlled (see Chapter 4). Importantly, the dual-track price system was defended through unorthodox reform economics that theorized and refined the prevailing reform practice. The decisive reform question in the mid-1980s was therefore whether to maintain and improve the dual-track price system or to abolish it. Defenders of the dual-track price system acknowledged that corruption was a problem, but they did not see abolition of the system as an acceptable solution. In pursuing reforms, they instead advocated for rigorous interdisciplinary, social-scientific inquiry. These gradualist reformers believed that an easy solution to the colossal challenge of China's economic transformation could not be deduced from pure theoretical analysis. China could make its own way cautiously, and it had to use a range of theories and experiences—both foreign and domestic—to assess its progress and trajectory of development.

There is a surprising parallel with the *Salt and Iron Debate* (see Chapter 1). The basic outlook of the defenders of the dual-track price system resembles, to some extent, that of Sang Hongyang. Both focused on their respective given realities, such as (natural) monopolies, seasonal

fluctuations, and the structures of a command economy, and how they could be mobilized to improve the workings of the economy; a supposed ideal state or target model was to be excluded from consideration. An emphasis on the feasible rather than on the ideal might be misunderstood as avoidance of fundamental change. However, the dual-track price system brought forth historic transformations of rare intensity and scope. The basic logic of the dual-track price system was at the heart of China's transformation from a poor agricultural country with revolutionary ambitions to one of global capitalism's manufacturing powerhouses.

This pragmatic stance vis-à-vis economic policy is certainly not uniquely Chinese. As the vigorous debates recounted in this book demonstrate, China's tradition is itself anything but internally uniform. We saw in Chapter 2 that the war economies of the major belligerent powers of the Second World War relied on a pragmatic approach similar to that advocated by China's gradualist reform economists decades later. As John Kenneth Galbraith has argued, in the case of the United States, price control relied to a large extent on the use of prevailing economic practices, such as the customer relations of monopolistic or oligopolistic suppliers. The successful general price freeze worked because it used empirically observed rather than theoretically derived prices. With regard to the transformation from a planned war economy to a postwar market economy, it was structurally similar to the challenge of market reforms in a socialist command economy. The pragmatic, gradual approach of the United Kingdom, as recounted by Alex Cairncross during his visit to China, presented an alternative to the overnight liberalization of the type that had been implemented in the US, against the best advice of some of the most famous American economists of the time. In postwar West Germany too, the ordoliberal approach of wholesale price liberalization competed with a dual-track approach similar to the one that prevailed in China in the 1980s.

In the foregoing chapters, I showed that China's gradualist and pragmatic approach to economic policymaking has been forcefully and repeatedly contested by those in favor of a sudden leap into an unregulated market economy. Gradualist experimentalism was by no means a foregone conclusion; it was defended over the course of fierce intellectual and political struggles. At the crossroads of the 1980s, China escaped shock therapy. Instead of experiencing severe economic decline and deindustrialization, as did Russia and several other transition economies, China's dual-track reforms laid the institutional and structural foundations for its economic ascent under tight political control by the party and the state.

The Path Was Set

The 1980s set in motion the process of China's marketization. Many of the young economists who emerged as strategic defenders of the dual-track approach of adjusting to the market in the 1980s fell out of favor, along with Zhao Ziyang, in 1989. After the military crackdown on Tiananmen Square and the imprisonment of Zhao (then–General Secretary of the Chinese Communist Party), some of China's brightest reform economists vanished from the scene of policymaking (see Chapter 8). The reform approach they helped to shape and defend has survived and has continued to be contested. Throughout the 1990s, the economics profession in China was remodeled to align with the international neoclassical mainstream (Cohn, 2017). Neoliberal reformers made deep inroads in the arenas of ownership, the labor market, and the health care system, among others. But the core of the Chinese economic system was never destroyed in one big bang. Instead, it was fundamentally transformed by means of a dynamic of growth and globalization under the active guidance of the state.

In October 1992, after Deng Xiaoping had restarted the reform agenda with his Southern Tour, the 14th CPC National Congress made the formal decision to establish a Socialist Market Economy with Chinese Characteristics. Jiang Zemin, Zhao Ziyang's successor as General Secretary, explained this new so-called leading concept:

Whether the emphasis was on planning or on market regulation was not the essential distinction between socialism and capitalism. This brilliant thesis has helped free us from the restrictive notion that the planned economy and the market economy belong to basically different social systems, thus bringing about a great breakthrough in our understanding of the relation between planning and market regulation.¹²

This decision marked a political breakthrough for a forceful restarting of the marketization agenda. The official declaration of a socialist market economy signaled that the Chinese leadership of the 1990s was willing to shatter all remaining boundaries to the operation of market forces, in the name of economic progress. Their first step in this direction was the far-reaching price liberalization of 1992 to 1993. On the surface, this price liberalization resembled the big bang agenda that had been avoided in the 1980s. Controls over essential consumer and

¹² Jiang Zemin, "Full Text of Jiang Zemin's Report at 14th Party Congress, 1992," online: http://www.bjreview.com.cn/document/txt/2011-03/29/content_363504.htm, last updated March 29, 2011

producer goods were now dismantled step-by-step. Among those targeted were key commodities such as grain, steel, coal, and oil. However, because of the drastically different status of the early-1990s Chinese economy—when compared even with the dynamics of the late 1980s—the relative impact of this “big bang” was far smaller than it would have been only a few years earlier.

As Naughton (1995, 289–90) argues in his classic account of China’s economic reform, the economy had already been deeply marketized when several essential plan prices were abolished: “The plan had already become an island surrounded by an ocean of market price transactions” (ibid., 290). This is evidenced in Figures 5 through 7 of the Introduction. We observe that for retail, agriculture, and producer goods the share of government-set prices resembles the shoulder of a mountain. The market share in all three sectors increased as a result of the universalization of the dual-track system, and government-set prices diminished in their importance. A big bang in 1986—or even in 1988—would have been catastrophic. By 1992, this same liberalization effort was akin to jumping off a low-standing rock at the base of a mountain from which one has just descended.

The 1992 and 1993 price liberalizations gave rise to the only episode in China’s reform period in which inflation outpaced economic growth (see Figure 4 of the Introduction). But it was not the kind of hyperinflation that had swept Russia (see Figure 3 of the Introduction). The combination of deep and gradual marketization that had preceded liberalization, as well as the assertion of state power in 1989, ensured that the “small bang” of 1992 was constrained enough to preserve core economic institutions. The state maintained its control over the “commanding heights” of China’s economy as it switched from direct planning to indirect regulation through the state’s participation in the market. China grew into global capitalism without losing control over its domestic economy.

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