

The Tao of Adam Smith

(By James A. Dorn*, The Asian Wall Street Journal, 18 August 1997)

*Mr. Dorn is vice president for academic affairs at the Cato Institute.

China's goal of building a "socialist market economy" is a grand illusion. Market socialism, even with "Chinese characteristics," is a half-baked system and, like the Yugoslav experiment with workers' management, is destined to fail. The reason is simple: 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.

But China and its leaders should not fear that to say this is to enjoin China to copy the West. In fact, classic Chinese traditions, of much longer pedigree than the ones that produced the idea of a "socialist market economy," point the way toward the free market.

The collapse of the Soviet Union and the failure of central planning have ended the debate over whether planning is superior to the market. As Liu Ji, vice president of the Chinese Academy of Social Sciences, remarked at a recent conference in Shanghai organized by the U.S. Cato Institute, "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. What China's leaders want are not "free private markets," as Nobel laureate Milton Friedman recommended in 1988 at Cato's first Shanghai conference, but regulated socialist markets. The ruling elite prefers the visible hand of government to the invisible hand of the market.

Real 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.

F.A. Hayek pointed out more than 60 years ago that, "To assume that it is possible to create conditions of full competition without making those who are responsible for decisions pay for their mistakes seems to be pure illusion." So long as state-owned enterprises face a soft budget constraint and there are no private owners with salable shares of stock, managers will have little incentive to be efficient.

The central principle of a true market system is the principle of spontaneous order -- that is, the notion that a system based on voluntary exchange will naturally lead to economic and social harmony if individual rights to liberty and property are safeguarded. When people are free to pursue their own interests, provided they respect the equal rights of others and do not initiate force, there are socially beneficial gains from trade. Free private markets tend to make people responsible and responsive. Adam Smith's "simple system of natural liberty" has both a moral foundation and a beneficial outcome. By allowing individuals the freedom to discover their comparative advantage and to trade, market liberalism has produced great wealth wherever it has been tried, with no better example than Hong Kong.

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." When government is limited, it can help cultivate an environment in which individuals can pursue happiness and practice virtue (te).

In the Tao Te Ching, written more than 2,000 years before Smith's "Wealth of Nations," Lao Tzu instructed the sage-ruler to adopt the principle of noninterference as the best way to achieve happiness and prosperity: "Take no action and the people of themselves are transformed . . . Engage in no activity and the people of themselves become prosperous." He recognized that "the more laws and orders are made prominent, the more thieves and robbers there will be." Corruption stems not from freedom but from freedom's being overly constrained by government. 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 problem 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, the challenge is to throw state enterprises "into the sea of the market economy."

China's state-owned enterprises cannot be revitalized; they are already dead. Last year, for the first time since 1949, state enterprises as a whole suffered a net loss, and in the first half of this year losses have grown by 9%. SOEs consume more than 50% of state investment funds, employ 66% of the urban workforce, but produce less than 30% of total output. The best medicine would be to nourish the nonstate sector, which now accounts for more than 70% of industrial output value, and allow new forms of ownership to evolve.

China should embrace the healthy hand of Hong Kong's free private market rather than risk the future by holding onto the dead hand of state ownership and government planning. China's leaders should have the courage to go beyond the present 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 to relieve the government of a growing debt that could strangle the vibrant nonstate sector. Making large SOEs the "pillars" of the national economy by "corporatizing" them, with the government holding all or most of the stock shares, is a recipe for disaster. That would be market socialism in spades, yet that is the course which China now seems intent on taking.

China can learn from the West, but it can also turn to its own ancient heritage and embrace "market Taoism" as the natural path to freedom and prosperity. In the words of Czech President Vaclav Havel, "The only economic system that works is a market economy, in which everything belongs to someone -- which means that someone is responsible for everything . . . 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."