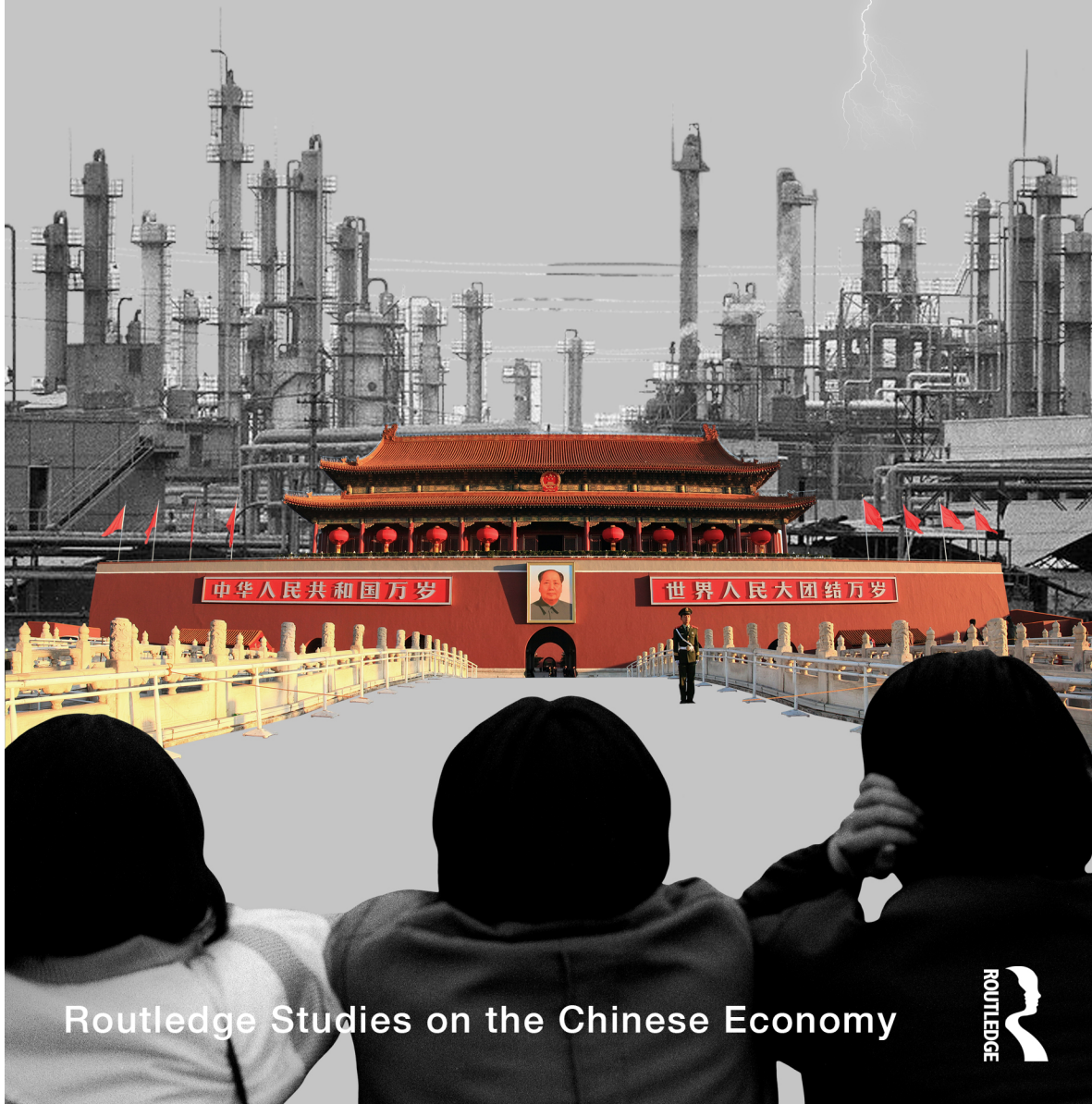


ISABELLA M. WEBER

# HOW CHINA ESCAPED SHOCK THERAPY

The Market Reform Debate



Routledge Studies on the Chinese Economy

ROUTLEDGE  


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 Isabella Weber, drawing on interviews of the participants and others together with many new sources of unpublished and published information, does a masterful job of explaining how this debate evolved and its ultimate impact.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, Harvard University, Director of the  
Harvard Institute for International Development, 1980–1995

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, The University of Texas at Austin,  
former Chief Technical adviser to China's State Planning  
Commission for macroeconomic reform

Isabella M. 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 MILANOVIĆ, LSE and CUNY, former Lead  
Economist, World Bank Research Department

Isabella M. Weber succeeds in offering a powerful account of China's reform-era market creation that is of acute interest to economists and historians alike. Her 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 and with Chinese roots in a period almost two millennia earlier.

R. BIN WONG, Director of the UCLA Asia  
Institute and Distinguished Professor of History

China's debates in the 1980s about reform of the non-market economy are centrally important to understanding global political economy in the 21st 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 M. 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, University of Cambridge, Founding Director  
of the University's Centre of Development Studies



# HOW CHINA ESCAPED SHOCK THERAPY

China has become deeply integrated into the world economy. Yet, gradual marketization has facilitated the country's rise without leading to its wholesale assimilation to global neoliberalism. This book 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. Based on extensive research, including interviews with key Chinese and international participants and World Bank officials as well as insights gleaned from unpublished documents, the book charts the debate that ultimately enabled China to follow a path to gradual reindustrialization. Beyond shedding light on the crossroads of the 1980s, it reveals the intellectual foundations of state-market relations in reform-era China through a *longue durée* lens. Overall, the book delivers an original perspective on China's economic model and its continuing contestations from within and from without.

**Isabella M. Weber** is Assistant Professor of Economics at the University of Massachusetts, Amherst.

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# HOW CHINA ESCAPED SHOCK THERAPY

The Market Reform Debate

*Isabella M. Weber*

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# PREFACE

I grew up in the 1990s, in a city located about an hour's drive from what used to be the Iron Curtain. During my youth, the sense of capitalist triumphalism as well as the deep social divide between East and West Germany was a constant, subtle theme. The global socialist past was present through the stories of my relatives and friends.

In 1987, the year I was born, my grandparents traveled to China. They cruised down the Yangzi River just a few months after the famous international economics conference had taken place on a boat floating down that same river. They liked to tell the story of a young Chinese student who had accompanied them as interpreter. He told them about the ongoing cultural opening and the wide-ranging debates but also alluded to a sense of fear that all this could come to a sudden end. Some weeks after the submission of my PhD, on which this book is based, my grandmother passed away. In her house, I was amazed to find a wealth of pictures and newspaper clippings about 1980s China, including notes on some of the famous reform economists discussed in the pages of this book.

I entered my undergraduate program in Berlin during the 2008 global financial meltdown. I was one of many students shocked to find that our economics professors had little to say about the deeper reasons for the global crisis. A year later, I went to study at Peking University. Irritated with textbook economics and curious about the Chinese economy, I listened to lectures in some of China's most prestigious management and economics programs. To my astonishment, even though China's economic system was clearly different, the exact same economics was taught from the same American textbooks from which I had studied in Berlin. This observation led me to a question: How had China's economics converged with the global mainstream since the Maoist period? Back in Berlin, I worked with colleagues from the former German Democratic Republic, whose lives had drastically changed as a result of the fall of the wall. Their biographies

confronted me with a second question: Why had East Germany's history taken a different course from China's? These two broad questions ultimately led to this book, which attempts to contribute toward answers.

In search of a plurality of economic theories, I entered graduate school at The New School for Social Research and was later accepted as a PhD student, advised by Peter Nolan at the University of Cambridge. Peter guided my pursuit of the central question of this book: On what intellectual grounds did China escape shock therapy in the 1980s? My research would have been entirely impossible without his relentless support and trust and without New School Economics. Thanks to Peter, I had the opportunity to interview a wide range of domestic and international participants and observers of China's fierce 1980s reform debate. Their stories are foundational to this book.

As I finalize this manuscript in 2020, the anniversary of the watershed year of 1989 has recently passed and the world is shattered by the COVID-19 pandemic. Tensions between the United States and China have increased to a level that leads many commentators to speak of a "new Cold War." I hope this history of China's escape from shock therapy in the 1980s and its reluctance to adopt the neoliberal version of capitalism in a wholesale fashion may shed some light on the present moment.

Many people have been crucial to this project. Foremost, I would like to thank all my interviewees who took the time to share their memories and perspectives on China's 1980s with me. With apologies to anyone I have forgotten, I am deeply grateful to Iwo Amelung, Bai Nanfeng, Tracy Blagden, Adrian Bradshaw, Ha-Joon Chang, Melinda Cooper, Cui Zhiyuan, Chun Xiao, Maxime Desmarais-Tremblay, Isabel Estevez, Jacob Eyferth, Nancy Folbre, Duncan Foley, Giorgos Galanis, James Galbraith, Julian Gewirtz, Benjamin Hall, Carol Heim, Lawrence King, David Kotz, János Kovács, Michael Kuczynski, Rebecca Karl, Leon Kunz, Michael Landesmann, Lei Bing, Liang Junshang, Aurelia Li, Edwin Lim, Lin Chun, Cyril Lin, Liu Hong, Liu Kang, Dic Lo, Luo Xiaopeng, Mariana Mazzucato, Maya McCollum, Branko Milanović, John Moffett, Luiza Nassif Pires, Jose Bastos Neves, Terry Peach, George Peden, Dwight Perkins, Stephen Perry, Robert Pollin, Joshua Rahtz, Carl Riskin, Eberhard Sandschneider, Leon Semieniuk, Anwar Shaikh, Fan Shitao, Bertram Schefold, Quinn Slobodian, Peter Sowden, Malcolm Thompson, Jan Toporowski, Vamsi Vakulabharanam, Vela Velupillai, Wang Xiaoqiang, Wang Xiaolu, Wei Zhong, Tom Westland, Felix Wemheuer, Adrian Wood, Bin Wong, Wu Jinglian, Zhu Ling, and Jean Zimmer.

This research has been made possible thanks to financial support by the financial support I received from the European Recovery Program, the Cambridge Trust, the Suzy Paine Fund, the Cambridge Political Economy Trust, the Universities' China Committee in London, the School of Public Management at Tsinghua University, the China Center for Economic Studies at Fudan University, the Greta Burkill Fund, the Bruckmann Fund, and the Department of Economics and the Political Economy Research Institute at the University of Massachusetts, Amherst.

The companionship and solidarity of my friends in Beijing, Berlin, Cambridge, London, New York, Nuremberg, and Amherst kept me going when my energies flagged. Conversations with my sister Anna-Magdalena Schaupp helped me regain enthusiasm when I was in despair. Gregor Semieniuk accompanied me day in and day out and critically commented on the manuscript as it evolved. And finally, without the love, trust, and support of my parents, I would never have done a PhD, let alone written this book. I extend to them all my deepest affection and gratitude.

# ABBREVIATIONS

<b>CASS</b>	Chinese Academy of Social Sciences
<b>CESRRI</b>	China Economic System Reform Research Institute
<b>CPC</b>	Communist Party of China
<b>OPA</b>	Office of Price Administration
<b>PRC</b>	People's Republic of China
<b>RMB</b>	Renminbi

# FIGURES

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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.<sup>1</sup> 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). But this did not result in the anticipated universalization of the "Western" economic model. 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 that 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 a 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.

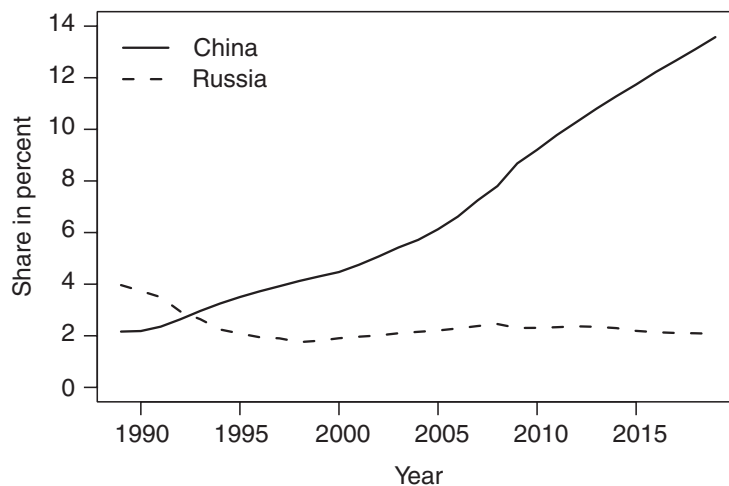
What was at stake in China's market reform debate is illustrated by the contrast between China's rise and Russia's economic collapse (Nolan, 1995). Shock therapy—the quintessentially neoliberal policy prescript—had been applied in Russia, the other former giant of state socialism (Jessop, 2002, 2018). Nobel Memorial Prize laureate Joseph Stiglitz (2014, 37) attests "a

## 2 Introduction

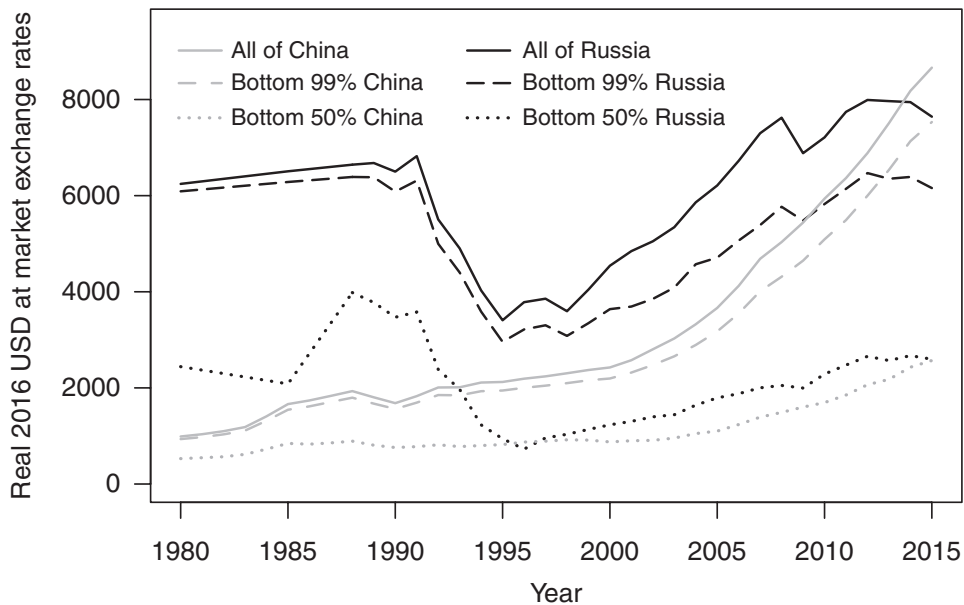
causal link between Russia’s policies and its poor performance.” Russia’s and China’s positions in the world economy have been reversed since they implemented different modes of marketization. Russia’s share of world GDP almost halved, from 3.7 percent in 1990 to about 2 percent in 2017, while China’s share increased close to sixfold, from a mere 2.2 percent to about one-eighth of global output (see Figure 0.1). Russia underwent dramatic deindustrialization, while China became the proverbial workshop of world capitalism.<sup>2</sup> 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 0.2).<sup>3</sup> As a result of shock therapy, Russia experienced a rise in mortality beyond that of any previous peacetime experiences of an industrialized country (Notzon et al., 1998).<sup>4</sup>

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 of 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, 34).



**FIGURE 0.1** China’s and Russia’s Shares in World GDP, 1990–2017. Source: World Bank, 2019.



**FIGURE 0.2** China’s and Russia’s Average Incomes per Adult by Population Quantiles, 1980–2015. Source: Alvaredo et al., 2017.

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; Chang, 2002; Davies, 2018). Its purpose is to fortify the market. In the most basic terms, this means the protection of free prices as the core economic 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 et al., 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,b). 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 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, 249–250). 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, 2022).

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 a part of shock therapy since its inception in the West German postwar price and currency reform under Ludwig Erhard (Fuhrmann, 2017, 167–170; Weber, 2020b, 2021). 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 et al., 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.

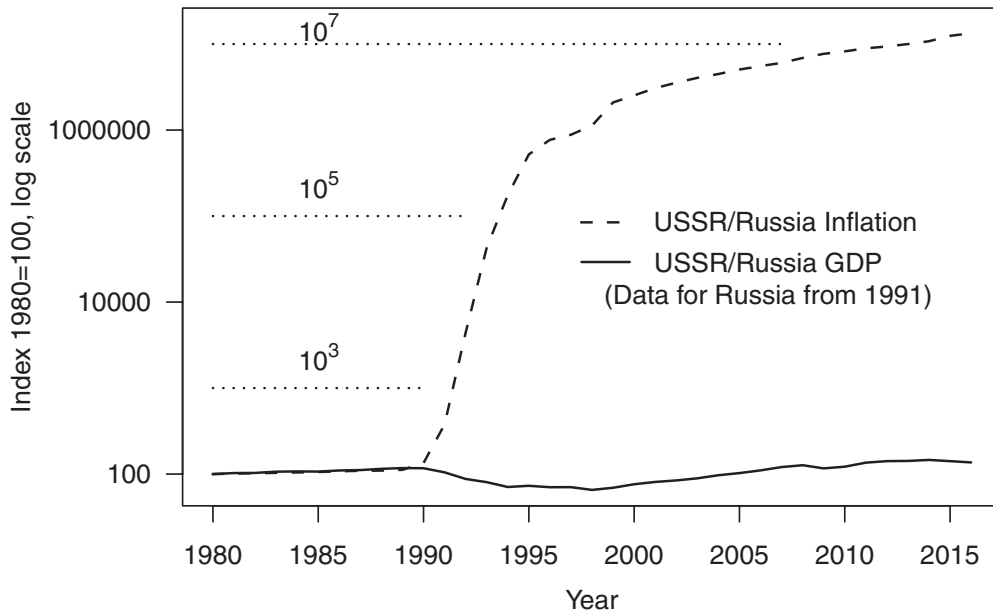
This is a perversion of Adam Smith’s famous metaphor. Smith, a close observer of the Industrial Revolution unfolding in front of his eyes, saw the human “propensity to truck, barter and exchange one thing for another” as the “principle which gives occasion to the division of labour” (Smith, [1776] 1999, 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., 121–126). 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).<sup>5</sup>

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 0.3).<sup>6</sup> 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).<sup>7</sup> Beyond the devastation documented by 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

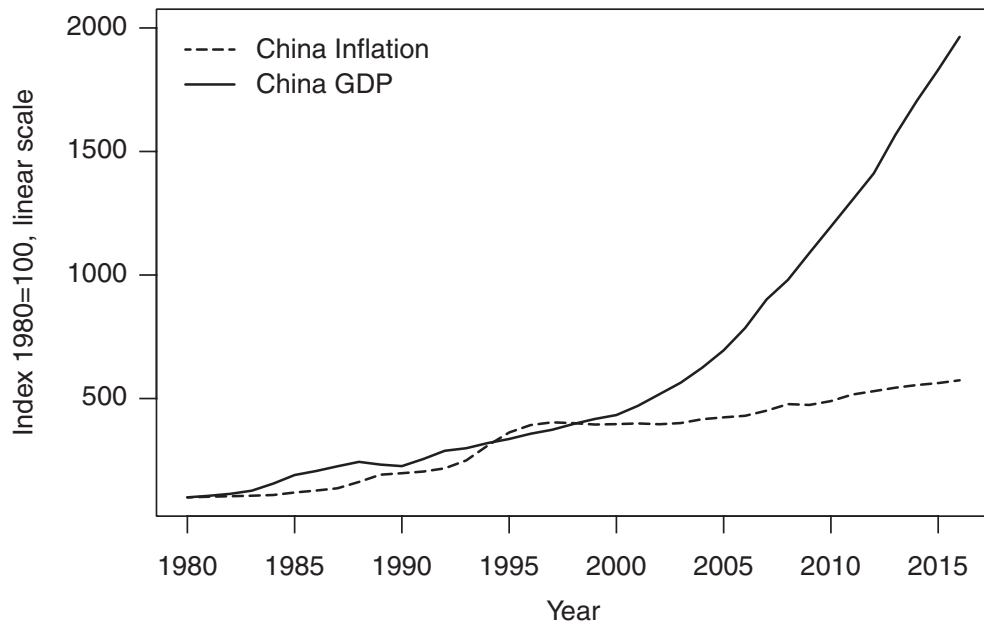


**FIGURE 0.3** USSR and Russia (from 1990) Consumer Price Index and Real GDP, 1980–2016. Sources: CPI USSR, 1971–1990 (IMF et al., 1991, 100); CPI Russia, 1991 (Filatochev et al., 1992, 746), 1992 (Sachs, 1994b, 70), 1993–2016 (IMF, 2017); GDP (Alvaredo et al., 2017).

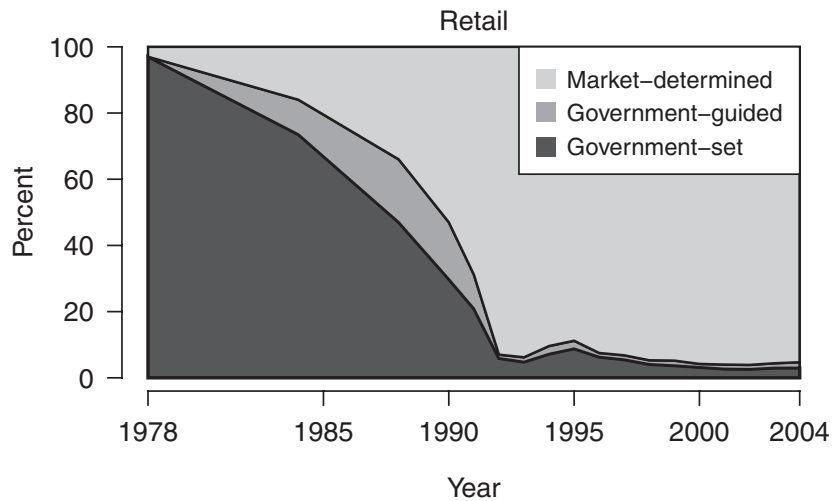
fast (see Figure 0.4). Instead of destroying the existing price and planning system in the hope that a market economy would somehow emerge “from the ruins,” China pursued an experimentalist approach that used the given institutional realities to construct a new economic system. The state gradually re-created 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 0.5, 0.6, and 0.7).

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



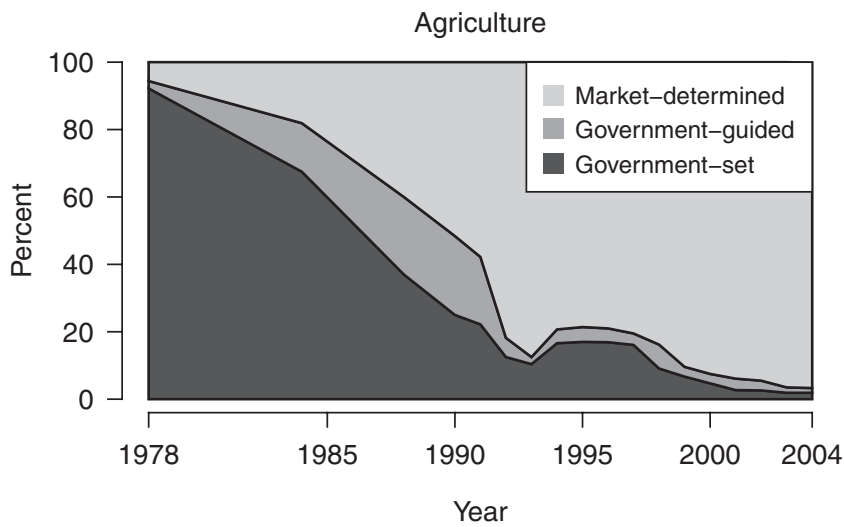


**FIGURE 0.4** China CPI and Real GDP, 1980–2016. Sources: CPI (IMF, 2017); GDP (Alvaredo et al., 2017).

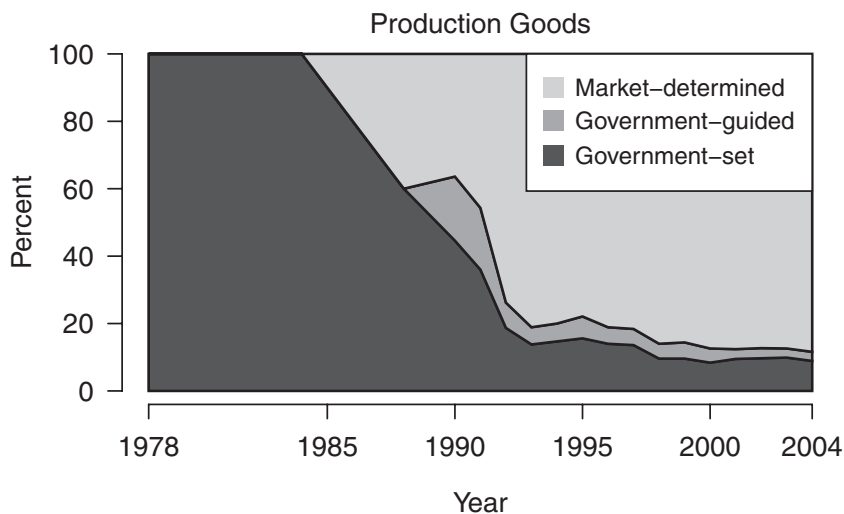


**FIGURE 0.5** Changes in the Price Determination of Retail Products, 1978–2004.

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 production links without replacing them with market relations. In this void, neither the old command structures nor the



**FIGURE 0.6** Changes in the Price Formation of Agricultural Products, 1978–2004.



**FIGURE 0.7** Changes in the Price Determination of Production Materials, 1978–2004.  
Source: Cheng Zhiping (2006, 163).

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.<sup>8</sup> 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.

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 et al. (1993); Peter Nolan and Dong Fureng (1990); Edwin Lim (2008, 2014); Lu Mai and Feng Mingliang (2012); Sun 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 have 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, 2020b, 2021). Some prominent institutionalist economists, such as John Kenneth Galbraith in the United States and Alec Cairncross in the UK, 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 re-establish 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 the "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.

### Notes

- 1 See Weber (2018, 2020a) for an in-depth discussion of this point.
- 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 et al. (2006); and Stuckler et al. (2009).
- 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, 161–199). 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 how 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 model could have been fully institutionalized (Wood, 1989). 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 my review of Gewirtz for a more detailed analysis (Weber, 2019a).