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# The Primacy of Property in a Liberal Constitutional Order

## *Lessons for China*

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JAMES A. DORN

China's march toward a market economy, which began in 1978, has been slow but steady. In 1980, China rated very low on the Economic Freedom of the World (EFW) index, achieving a score of only a 3.7 out of 10, in contrast to Hong Kong, which scored 8.7 and was ranked number one in the world. Hong Kong has continued to be ranked the freest economy in the world, with a score of 8.8 in 2000 (the last year for which data are available), whereas China's score has increased to 5.3 (Gwartney and Lawson 2002, 83, 110). China, however, is a huge country, and its dynamic, market-oriented coastal areas, when scored separately, reflect greater economic freedom than for the country as a whole (Fan, Wang, and Zhang 2001).

The liberalization of foreign trade has helped to transform Chinese industry and has exposed China to new ideas and new markets. China's recent entry into the World Trade Organization (WTO) will deepen economic reform and strengthen civil society.

Economic freedom is multidimensional. Its basic features, as measured by the EFW index, are "personal choice, voluntary exchange, freedom to compete, and protection of person and property" (Gwartney and Lawson 2002, 5). That China ranks 101st out of 123 countries in terms of overall economic freedom reflects the lack of secure private-property rights and the strong government presence in the economy.

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In the future, China will need to develop its constitutional and institutional infrastructure to protect property rights better and to limit government intervention if it is to achieve the credibility needed to comply with WTO rules and to create real capital markets. China can learn much from Hong Kong's success. If the constitutional order of freedom characteristic of Hong Kong can spread to China, then China's future will be bright.

In this article, I focus on the primacy of property rights for a free society. As Milton Friedman notes, "Property rights are not only a source of economic freedom. They are also a source of political freedom" (2002, xvii). I begin by defining property rights and showing their moral and practical significance for a liberal constitutional order. The legitimate function of government is to protect property and thereby to ensure justice. Once government safeguards persons and property under a rule of law, a spontaneous market-liberal order can emerge to coordinate economic activity and to create new wealth. I show how the idea of spontaneous order, which lies at the heart of a liberal constitutional order, is fully compatible with China's ancient culture, as seen in the writings of Lao Tzu. China must move from market socialism to "market Taoism"—from constitutional fiat to constitutional freedom. That is why property rights and limited government are so important for its future.

## Property, Freedom, and Justice

Property is often thought of only in physical terms, but that conception of it is misleading. A more accurate portrayal of property is as a bundle of rights and correlative obligations that are consistent with individual freedom. Indeed, according to James Madison, the main architect of the U. S. Constitution, "In its larger and juster meaning, it [property] embraces every thing to which a man may attach a value and have a right; and *which leaves to every one else the like advantage*" ([1792] 1906, 101, emphasis in original).

Under the rubric of property, Madison included "a man's land, or merchandize, or money," as well as the property a person has in "his opinions and the free communication of them" and especially the property a person has "in his religious opinions, and in the profession and practice dictated by them." An individual also "has property very dear to him in the safety and liberty of his person" and "an equal property in the free use of his faculties and free choice of the objects on which to employ them." In brief, "as a man is said to have a right to his property, he may be equally said to have a property in his rights" ([1792] 1906, 101).

Madison followed in the footsteps of the great classical liberal thinker John Locke. In 1690 in his *Second Treatise of Government*, Locke defined property as "lives, liberties, and estates" (§ 123). He questioned the so-called divine right of kings and argued that property is a fundamental human right—a moral or "natural right"—that exists prior to government. All individuals have the right to protect their property from aggressors and

the correlative obligation to restrain from harming others, except in exercising the legitimate right to self-defense. Thus, everyone is equally free to pursue his or her happiness, provided everyone adheres to the basic principle of noninterference.<sup>1</sup>

According to Madison, the primary function of government is “to protect property of every sort; as well that which lies in the various rights of individuals, as that which the term particularly expresses. This being the end of government, that alone is a *just* government, which *impartially* secures to every man, whatever is his *own*” ([1792] 1906, 102, emphasis in original). Hence, just as *freedom* depends on the moral right to property, broadly conceived, *justice* depends on limiting the use of force—whether individual or collective—to the safeguarding of life, liberty, and estate. Justice does not refer to outcomes but to rules: to be just, rules must be applied equally and not violate our basic right to noninterference.

Justice is simple to understand in the liberal constitutional order: it is merely the absence of injustice, which is defined as the wrongful taking of life, liberty, or property. As the brilliant French liberal Frederic Bastiat wrote in 1850,

When law and force confine a man within the bounds of justice, they do not impose anything on him but a mere negation. They impose on him only the obligation to refrain from injuring others. They do not infringe on his personality or his liberty or his property. They merely safeguard the personality, the liberty, and the property of others. They stand on the defensive; they defend the equal right of all. They fulfill a mission whose harmlessness is evident, whose utility is palpable, and whose legitimacy is uncontested. (1964, 65)

In sum, property, freedom, and justice are inseparable in the liberal constitutional order: when private-property rights are violated, individual freedom and justice suffer.

## Private-Property Rights, Economic Freedom, and Prosperity

Economic freedom depends crucially on the enforcement of private-property rights, which include the exclusive right to use one’s justly (freely) acquired property and the right to sell property or to partition the bundle of rights. Free markets depend on well-defined private-property rights, which means the legal system must be based on the rule of law and on limited government (Niskanen 2002).

There can be no real competitive markets—no “marketization” or capitalization—without privatization (that is, freely transferable private-property rights).<sup>2</sup> As Armen Alchian, a pioneer in law and economics, emphasizes, “Marketability implies

1. On the right to noninterference as a fundamental moral right, see Pilon 1979, 1185.

2. Ludwig von Mises and F. A. Hayek were instrumental in conveying this idea. See Hayek [1935] 1975 and 1948, chaps. 7–9. On the Mises/Hayek critique of socialism, see Lavoie 1990, 76–82.

*capitalization* of future effects on to present values. Thus, long-range effects are thrust back on to the current owner of the marketable value of the goods. He will heed the long-run effects of current decisions more carefully than if the rights were not transferable” (1967, 12).

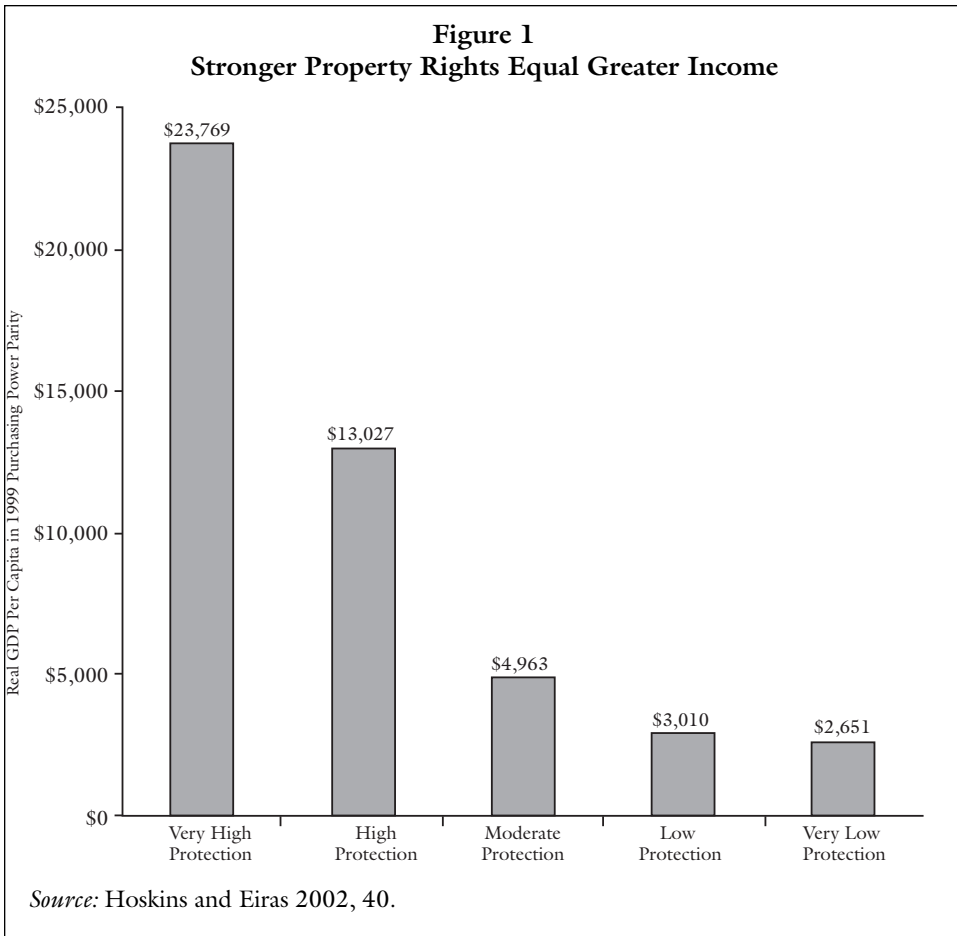
The salability or transferability of private property (for example, land, shares of corporate stock, and other capital assets) means that owners can discover the present (capital) value of future expected net-income streams. It is possible to calculate those values because market interest rates can be used to discount future expected profits into their present values, as reflected in asset prices. Without competitive markets based on secure private-property rights, no one can know how to allocate capital efficiently to alternative uses based on consumer preferences. In the absence of real capital markets, investment decisions naturally will be politicized, as they are in China.

The attenuation of private-property rights lowers the market value of those rights and reduces individual freedom (Alchian 1977; Jensen and Meckling 1985). If the end and criterion of economic development is greater individual freedom, in the sense of an expansion of one’s range of alternatives or choices, then any weakening of private-property rights reduces economic freedom and slows human development. Peter Bauer, in line with classical liberals going back to Adam Smith, has made a strong case for freedom of choice as the primary criterion of development: “I regard the extension of the range of choice, that is, an increase in the range of effective alternatives open to the people, as the principle objective and criterion of economic development; and I judge a measure principally by its probable effects on the range of alternatives open to individuals” (1957, 113–14).

Bastiat had that conception of development in mind when he wrote, “The best chance of progress lies in justice and liberty” (1964, 137). In his famous essay “The Law,” he recognized the importance of secure private-property rights, limited government, and economic freedom for personal and economic development: “It is under the law of justice, under the rule of right, under the influence of liberty, security, stability, and responsibility, that every man will attain to the full worth and dignity of his being, and that mankind will achieve, in a calm and orderly way—slowly, no doubt, but surely—the progress to which it is destined” (1964, 94).

Bastiat saw progress as an evolutionary process in which individuals learn by trial and error. That process is enhanced by a free-market system resting on private-property rights. He understood the institutional infrastructure of a market system and recognized that competition would allow people the freedom to discover new information and to learn from their mistakes. Thus, like F. A. Hayek (1978), Bastiat viewed competition as a discovery process. He also recognized that freedom would promote social development: “Social organs too are so constituted as to develop harmoniously in the open air of liberty” (1964, 95).

History has shown that the countries with the strongest protection of private-property rights and the greatest amount of economic freedom also achieve the high-



est standards of living. In a study of 150 countries, Lee Hoskins and Ana Eiras (2002) found that countries with secure private-property rights have created more wealth (as measured by real gross domestic product [GDP] per capita) than countries in which private-property rights are insecure and corruption is high (see figure 1). James Gwartney and Robert Lawson (2002, 20) find a strong correlation between economic freedom, as measured by the EFW index, and income per capita, the rate of economic growth, and life expectancy. Those findings point to the importance of private-property rights and limited government not only for creating a just society in the Madisonian sense but also for alleviating poverty.

### The Law of Liberty and Spontaneous Order

When protection of persons and property is the overriding object of government and when people are free to choose, provided they respect the equal rights of others, then markets will coordinate economic decisions and lead to mutually beneficial exchanges. Such a voluntary or spontaneous order can arise only in a liberal constitutional order of

freedom, or what Hayek (1960) called a “constitution of liberty.” Equal freedom under the law of liberty is the hallmark of liberalism. “The free society,” writes Roger Pilon,

is a society of equal *rights*: stated most broadly, the right to be left alone in one’s person and property, the right to pursue one’s ends provided the equal rights of others are respected in the process, all of which is more precisely defined by reference to the property foundations of those rights and the basic proscription against taking that property. [Moreover,] the free society is . . . a society of equal *freedom*, at least insofar as that term connotes the freedom from interference that is described by our equal rights. (1983, 175, emphasis in original)

The idea that a harmonious economic and social order can emerge spontaneously from individual action—provided government enforces just rules that protect individual rights to life, liberty, and property—is central both to liberalism and to the case for limited government. As Hayek states, “under the enforcement of universal rules of just conduct, protecting a recognizable private domain of individuals, a spontaneous order of human activities of much greater complexity will form itself than could ever be produced by deliberate arrangement, and . . . in consequence the coercive activities of government should be limited to the enforcement of such rules” (1967, 162).

China’s leaders need to recognize the idea of spontaneous order. Their fear of chaos in the absence of strong government guided by the Chinese Communist Party (CCP) is misplaced. They fail to recognize that freedom under the law of justice is an alternative to unlimited freedom as well as to unlimited government. Chaos is a straw man meant to subdue the Chinese people and to keep the CCP in power. China’s leaders could learn much about spontaneous order by studying the work of Adam Smith and by returning to the thought of their own Lao Tzu, who discovered the principle of spontaneous order long before Smith.

### *The Tao of Adam Smith*

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

In Smith’s system of natural liberty, the government no longer would have the obligation of overseeing “the industry of private people, and of directing it towards the employments most suitable to the interest of the society”—an obligation “for the proper performance of which no human wisdom or knowledge could ever be sufficient” ([1776] 1937, 651).



Government would not disappear under Smith's market-liberal regime, but it would be limited narrowly to three major functions: (1) "the duty of protecting the society from the violence and invasion of other independent societies"; (2) "the duty of protecting, as far as possible, every member of society from the injustice or oppression of every other member of it"; and (3) "the duty of erecting and maintaining certain public works and certain public institutions" ([1776] 1937, 651).

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

The chief architect behind the Hong Kong economic miracle was Sir John Cowperthwaite, a Scot who admired the work of Adam Smith and other classical liberals. As Hong Kong's financial secretary from 1961 to 1971, Sir John constantly challenged attempts to increase the power and scope of government in that territory. Like Smith, he believed that free private markets would keep people alert to new opportunities by quickly penalizing mistakes and by rewarding success in the use of society's scarce resources. He understood that no system is perfect, but that, of all known economic systems, the market-price system, with its automatic feedback mechanism, has performed the best: "In the long run, the aggregate of decisions of individual businessmen, exercising individual judgment in a free economy, even if often mistaken, is less likely to do harm than the centralized decisions of a government, and certainly the harm is likely to be counteracted faster" (qtd. in N. Smith 1997, A14).

The idea that people have a natural tendency to make themselves better off if left alone to pursue their own interests and the notion that a *laissez-faire* system will be harmonious if government safeguards persons and property are the foundations of the West's vision of a market-liberal order, but they are also inherent in the ancient Chinese Taoist vision a self-regulating order—an order we properly might call "market Taoism" (Dorn 1997, 1998).

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

### *Lao Tzu and the Principle of Wu Wei*

China need not be confined to the ideological cage of market socialism by fear of copying Western traditions of market liberalism. The way of the market is universal.



The free-market economy is, as Václav Havel has stated so elegantly, “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” (1992, 62). Since 1978, market liberalization has increased substantially the standard of living of millions of Chinese, and individuals are beginning to express their feeling that private property is sacred. M. Pei reports, “In a 1993 poll of 5,455 respondents in six provinces, 78 percent agreed with the statement, ‘Private property is sacred and must not be violated’” (1998b, 76).

In considering what steps to take next, China’s leaders should look to their own ancient culture and rediscover the principle of spontaneous order—what Nobel laureate economist James M. Buchanan has called the “most important central principle in economics” (1979, 81–82). In the *Tao Te Ching*, written more than two thousand years before *The Wealth of Nations*, Lao Tzu instructed the sage (ruler) to adopt the principle of *wu wei* (noninterference) as the best means of achieving happiness and prosperity:

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

The foregoing passage implies that the more the state intervenes in everyday life, the more corruption will occur. Alternatively, if people are left alone to pursue their own happiness, a spontaneous market order will arise and allow people to create prosperity for themselves and their country. Like Lao Tzu, China’s leaders should realize that corruption stems not from freedom but from government’s excessive constraint of freedom. As Nobel laureate economist Gary Becker notes, “Markets grow up spontaneously, they are not organized by governments, they grow on their own. If individuals are given freedom, they will help to develop markets for products that one cannot imagine in advance” (1996, 75).

Just as the principle of spontaneous order is central to economic liberalism, the principle of *wu wei* is fundamental to Taoism. Rulers rule best when they rule least—that is, when they take “no unnatural action.”<sup>3</sup> Limiting government can help culti-

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3. Wing-Tsit Chan notes that the principle of *wu wei* does not mean “‘inactivity’ but rather ‘taking no action that is contrary to Nature’” (1963, 136). In essence, “wu wei . . . is the embodiment of suppleness, simplicity, and freedom” (H. Smith 1991, 208).

vate an environment in which individuals can pursue happiness and practice virtue (*te*). Thus, Lao Tzu writes in the *Tao te Ching*, “No action is undertaken, and yet nothing is left undone. An empire is often brought to order by having no activity” (Chan 1963, 162).

The challenge for China is to widen the *free* market and to provide the institutional infrastructure necessary to support *private* markets (Friedman 1990, 5). The solution is to discard market socialism and to make the transition to market Taoism. As Gao Shangquan stated when he was vice minister of the State Commission for Restructuring the Economy, the challenge is to throw state-owned enterprises (SOEs) “into the sea of the market economy” (qtd. in Chang 1997, 15).

### From Market Socialism to Market Taoism

Although China has made significant progress in moving toward a market system, much remains to be done in terms of creating the institutional infrastructure needed for a real market economy based on private property and freedom of contract. The existence of widespread state ownership remains a major hurdle in the transition to a private free-market system. Lin, Cai, and Li have pointed to the continuing “institutional incompatibility” between plan and market and have argued that “it is essential for the continuous growth of the Chinese economy to establish a transparent legal system that protects property rights so as to encourage innovations, technological progress, and domestic as well as foreign investments in China” (1996, 226).

China needs constitutional change that enshrines the principle of freedom and depoliticizes economic life. Then real capital markets can emerge to replace centralized investment planning and government controls on capital flows. Removing government from the market will solve the problem of institutional incompatibility and reduce corruption.

### *A Constitution of Liberty for China*

Economic and political reforms are inseparable. To depoliticize economic life, China ultimately must change its constitution from one that enshrines the CCP to one that protects persons and property. New thinking (*xin si wei*) will be required: the planning mentality will have to give way to the idea of freedom under the law. That idea, however, is not new, either in the West or in China. As Jixuan Hu writes, “By setting up a minimum group of constraints and letting human creativity work freely, we can create a better society without having to design it in detail. That is not a new idea, it is the idea of law, the idea of a constitution. Real constitutional government is a possible alternative to the dream of a perfectly designed society. . . . The idea is to apply the principle of self-organization” (1991, 44).

The recent amendment to Article 11 of China's constitution, which recognizes the importance of the nonstate sector and affords protection to private enterprise, is a step in the right direction. To move further toward a free society, however, China must continue to open its markets to the outside world and to abide by international law. In particular, as Pilon has emphasized, China needs "a constitution grounded in the rule of law, not in the rule of man; . . . a constitution of liberty" (1998, 352).

To accept that idea, however, means to understand and accept the notion of spontaneous order and the principle of nonintervention (*wu wei*) as the basis for economic, social, and political life. China's leaders and people can turn to the writings of Lao Tzu for guidance:

When taxes are too high,  
people go hungry.  
When the government is too intrusive,  
people lose their spirit.

Act for the people's benefit.  
Trust them; leave them alone.  
(Mitchell 1991, 75)

Deng Xiaoping implicitly recognized Lao Tzu's way of thinking when he wrote,

Our greatest success—and it is one we had by no means anticipated—has been the emergence of a large number of enterprises run by villages and townships. They were like a new force that just came into being spontaneously. . . . If the Central Committee made any contribution in this respect, it was only by laying down the correct policy of invigorating the domestic economy. The fact that this policy has had such a favorable result shows that we made a good decision. But this result was not anything that I or any of the other comrades had foreseen; it just came out of the blue.<sup>4</sup> (1987, 189)

Although China can return to its own vision of freedom by embracing and extending Lao Tzu's thought, the idea of market Taoism can be enhanced by a deeper understanding of classical liberal economic thought and a study of free-market institutions. In breaking the planning mentality, therefore, China can learn both from its own culture and from the West.

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

### *Creating Real Capital Markets in China*

The goal of creating viable *socialist* capital markets is an illusion (Nutter 1968). Modern global capital markets presuppose a transparent legal framework that protects private-property rights and allows the free flow of information. Asset prices then reflect the capitalized value of future profits. Without the right to buy and sell shares of stock freely in organized markets, and without competitively determined market interest rates, there can be no real capital markets and no way to determine true asset values.

Hernando de Soto, the author of *The Mystery of Capital*, aptly says, “Capital is that value, that additional value, that comes from things that are duly titled; . . . capital is also law” (qtd. in Fetting 2001, 23, 26). Countries remain poor when their leaders prevent privatization and fail to abide by the rule of law. Hong Kong is rich because it adheres to the rule of law and has market-supporting institutions, not because it has abundant physical capital.

The more secure are rights to future income, the more confidence individuals have in the future, the more breadth and depth capital markets have, and the more liquidity there will be. Likewise, any attenuation or weakening of private-property rights—including the rights to use, sell, and partition property—will produce less trust, less liquidity, and less wealth.

Denying Chinese entrepreneurs the freedom to specialize in ownership and risk taking will place them at a huge disadvantage in creating a financial architecture that can rival that of the West. As long as the state has a majority stake in enterprise ownership, investment decisions and managerial appointments will be politicized.

China’s inclusion in the WTO has begun a process of opening its pseudo capital markets to foreign competition and expertise. Foreign banks will have full access to the local currency market within five years. Most restrictions on foreign equity holding will be relaxed, and Western legal and accounting firms will have greater market access. Geographical limits on foreign insurance firms will be eliminated, and those firms will be allowed to offer a wider range of services, including pension annuities. Other liberalization measures, especially those that allow foreign firms direct trading and distribution rights within China, will spur competition and create an ever-larger nonstate sector (Groombridge 2000, 6–7).

To create real capital markets, China must make political reforms. The state must leave the ownership of capital to private individuals who will bear ultimate responsibility for the allocation of capital assets and who will not be subject to political control. That transformation will require major changes in the institutional infrastructure and a new way of thinking about the role of property rights in China’s socialist market economy. The WTO can help push China in that direction.

Beijing has propped up SOEs and created asset-management companies to take over nonperforming loans of state banks. Those measures, however, are not sufficient to cure the institutional cancer at the core of China’s ownership system. Highly inef-

ficient SOEs are starving private firms of capital. The government—that is, the CCP—remains the dominant owner of capital, and central authorities decide which firms may float shares on the stock exchanges. Recapitalizing state banks is meaningless if those banks continue to lend to SOEs and are driven by politics, not by markets. If China is to revitalize its firms and banks and is to prevent a financial meltdown, it must restructure and open its capital markets, not simply inject more funds into dying institutions. Private owners, with exclusive claims to net income and transferable shares, must be given greater scope and access to capital.

The challenge will be for the leadership to realize that China's future as a modern financial center depends on establishing trust. Foreign and domestic investors must have clearly defined rights to enterprise profits and must be guided by competitively determined rates of return and interest rates in making their investment decisions. The political challenge is to get government out of the business of allocating capital and to allow effective private ownership—something the CCP has not been willing to do except on a small scale.

The freedom to specialize in ownership and risk taking—and thus to choose among an array of assets with varying combinations of risk and reward—is an important factor promoting wealth creation (Alchian 1977, chap. 5). As private wealth grows, people will have an incentive to protect it against the state. How can the CCP be for the people if it prevents widespread private ownership?

The difficulty is to provide an incentive for China's leaders to accept private ownership as the norm rather than as the exception. Constitutional changes to give further protection to private property would be a welcome sign and would help to stem capital outflows and to attract new capital into China. As Zhong Wei, an economist at Beijing Normal University, recently stated, "The need for a constitutional amendment that adds the principle that private properties are inviolable has become quite urgent to curb private capital outflow[s]" (qtd. in Jia 2002, 5).

## Lessons for China

Social, economic, and political order can rest on coercion or consent. The liberal constitutional order of freedom has served the world well in bringing about peace and prosperity. The failure of central planning and the collapse of communism in eastern Europe and the Soviet Union have illustrated the futility of state control as a solution to the problem of social organization. Bastiat correctly said, "The solution of the social problem lies in liberty" (1964, 94).

China's greater reliance on markets since 1978 has transformed ethical practices gradually: voluntary exchanges are replacing state controls, and people are beginning to experience the spontaneous order of the marketplace. That cultural transformation is easily seen, especially in the coastal cities. As Jianying Zha writes, "The economic reforms have created new opportunities, new dreams, and to some extent, a new atmosphere and new mindsets. The old control system has weakened in many areas,

especially in the spheres of economy and lifestyle. There is a growing sense of increased space for personal freedom” (1995, 202).<sup>5</sup>

Zhang Shuguang, an economist at the Unirule Institute in Beijing, one of China’s first private think tanks, writes,

Mandatory economy and market economy belong to entirely different ideologies and different ethics. . . . Planned economy is based upon some idea of ideal society and beautiful imagination, but compulsory implementation has been its only means of realization. In such a system, [the] individual is but a screw in a machine, which is the state, and loses all its originality and creativeness. The basic ethics required in such a system is obedience. In the market system, which is a result of continuous development of equal exchange and division of labor, *the fundamental logic is free choice and equal status of individuals*. The corresponding ethics in [the] market system is mutual respect, mutual benefit, and mutual credit. (1996, 5, emphasis added)

Understanding those differences is the first step in China’s long march from market socialism to market Taoism and from constitutional fiat to constitutional order under the law of liberty.

In their book *China’s New Political Economy*, Susumu Yabuki and Stephen Harner find “a clear tendency toward higher GDP growth rates as the proportion of non-state-owned enterprise increases” (1999, 100). Provinces with greater economic freedom grew considerably faster than those with less freedom, as indicated by the size of the state sector. For example, Fujian, Guangdong, and Zhejiang—provinces where SOEs account for less than 30 percent of industrial output value—grew at rates close to 20 percent per annum on average from 1990 through 1995. In contrast, Qinghai, Heilongjiang, and the Ningxia Autonomous Region, where SOEs are the dominant producers, experienced much slower average growth rates, in the range of 7 to 8 percent per annum (Yabuki and Harner 1999, 99–100).<sup>6</sup>

The importance of foreign-funded enterprises in the coastal areas and of foreign trade in general cannot be underestimated. China has benefited tremendously from the presence of alternatives to SOEs. Experimentation with nonstate ownership forms has been highly successful. The government has recognized the importance of private ownership in creating wealth. The *People’s Daily* recently reported, “Zhang Dejiang, secretary of the Zhejiang Provincial Committee of the Communist Party of China,

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5. For a discussion of China’s emerging civil society, see Pei 1998a. Kathy Chen describes the model of development in China’s new urban centers, such as Shishi, as “*xiao zhenfu, da shehui*—small government, big society—which advocates less involvement by cash-strapped governments and more by society” (1996).

6. The 7 to 8 percent growth rates reported for SOE-dominated provinces are suspect because managers who are also CCP members have an incentive to overstate production and because inventories often have little *market* value. On the problem of measuring China’s growth, see Rawski 2002.

said that the contribution of the private sector in pushing forward the rapid economic growth of the province can not be overlooked” (“Chinese Private Economy” 2002).<sup>7</sup> It is now time to allow even greater freedom and to recognize not only the usefulness of private property but also its sanctity as a basic human right.

In an encouraging sign, the *People’s Daily* also recently reported that “A new research report on China’s social strata made by some scholars at the Chinese Academy of Social Sciences [CASS] says that private property will play the same role as state-owned property in forming the economic foundation and the overall national strength of socialist society” (“Chinese Private Economy” 2002). On the surface, this statement is absurd: private and state ownership are diametrically opposed—the first vests exclusive title in the individual and allows owners to sell their bundle of property rights; the second vests title in the state and its political apparatus, the CCP, and no individual has freely transferable rights. Yet, if we read between the lines, we can see that the CASS report signals that China may be ready to allow greater economic freedom by providing more security to private property. Indeed, at the 16th Party Congress, in November 2002, President Jiang Zemin boldly stated: “We need to . . . improve the legal system for protecting private property” (qtd. in McGregor and Kynge 2002, 3).

Five lessons should be carved in stone and constantly remembered as China moves from market socialism to market Taoism:

- Private property, freedom, and justice are inseparable.
- Justice requires limiting government to the protection of persons and property.
- Minimizing the use of force to defend life, liberty, and property maximizes freedom and creates a spontaneous market-liberal order.
- Private free markets are not only moral, but they create wealth by providing incentives to discover new ways of doing things and by increasing the range of alternatives.
- Governments rule best when they follow the rule of law and the principle of noninterference (*wu wei*).

The key to a successful future for China is not better government planning or more foreign aid, but rather a constitution that protects persons and property against the discretionary power of government and lays a framework for freedom under the rule of law. That is the legacy of Hong Kong and the challenge for China.

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7. The National Economic Research Institute in Beijing ranked Zhejiang second in terms of its progress toward a market economy compared to other provinces in 1999. Guangdong was ranked number one. See Fan, Wang, and Zhang 2001, 10. The NERI “marketization index” recognizes the importance of secure property rights and the rule of law in creating a market system: “One of the important aspects of market-oriented reform is the development of [a] rule of law, including the setting up of [a] legal framework for property rights protection and contract enforcement” (Fan, Wang, and Zhang 2001, 4).



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