

# CHINA'S FUTURE DEVELOPMENT: CHALLENGES AND OPPORTUNITIES

*James A. Dorn*

Only by matching the rule of law with the market economy  
can we achieve total success.

—Wu Jinglian

China's journey from central planning to market socialism since 1978 has been erratic, with many interruptions along the way. The end result, however, has been eye opening: the Middle Kingdom has become the world's largest trading nation, the second largest economy, and more than 500 million people have lifted themselves out of poverty as economic liberalization removed barriers to trade.

One of the enduring lessons from China's rise as an economic giant is that once people are given greater economic freedom, more autonomy, and stronger property rights, they will have a better chance of creating a harmonious and prosperous society (see Dorn 2019).

Nevertheless, China faces major challenges to its future development. There is still no genuine rule of law that effectively limits the power of government, no independent judiciary to enforce the rights promised in the nation's constitution, no free market for ideas that is

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James A. Dorn is a Senior Fellow and China specialist at the Cato Institute. This article was originally prepared for a conference on "China's Future Development," held in Hong Kong, October 25–26, 2018, and sponsored by the Shang Dao Institute.

essential for innovation and for avoiding major policy errors, no competitive political system that fosters a diversity of views, and a large state sector that stifles private initiative and breeds corruption. China's slowing growth rate, its increasing debt burden, environmental problems, and the increasing tension in U.S.-China relations compound the challenges facing Beijing.

President Xi Jinping, the most powerful leader since Mao Zedong, has used the rhetoric of free trade for the market in both goods and ideas. At the 2017 World Economic Forum in Davos, he stated: "We must remain committed to developing global free trade . . . and say no to protectionism" (Xi 2017a). Meanwhile, in his October 2017 report at the 19th National Congress of the Chinese Communist Party (CCP), he told his comrades: "We should follow the principle of letting a hundred flowers bloom and a hundred schools of thought contend" (Xi 2017b: 36–37).

While President Xi's rhetoric is notable, the reality is that China continues to protect its state-run monopolies, restricts entry to financial and other markets, violates intellectual property rights, and severely restricts free speech (see Lardy 2019). Indeed, the 2018 World Press Freedom Index, compiled by Reporters without Borders, ranked China 176th out of 180 countries—only four ranks above North Korea.<sup>1</sup>

The CCP (2013) pledges to "further emancipate the mind," and the Chinese Constitution states that citizens "enjoy freedom of speech, of the press, of assembly, of association" (Art. 35), and that "freedom of the person . . . is inviolable" (Art. 37). Yet those promises are empty in a powerful one-party state.

The closing of virtual private networks and the silencing of those who advocate a just rule of law and limited/constitutional government—such as Mao Yushi at the liberal Unirule Institute, whose website was shut down and office shuttered (Buckley 2018)—reflect a growing anti-liberal sentiment under Xi Jinping, who is now "President for life."

Sheng Hong, the director of Unirule, has argued that if China is to advance, the authorities must understand "the intrinsic tie between free trade and free expression." The logic is simple: "Free trade refers to the free exchange of commodities, and free expression

<sup>1</sup>See <https://rsf.org/en/ranking>.

refers to the free exchange of ideas. As ideas are more valuable than commodities, anyone that truly defends the freedom to trade will defend the freedom of expression” (Sheng 2017).

Premier Li Keqiang has argued that, if China is to reach its full potential, it must “get the relationship right between the government and the market” and boost the “vitality of the market” (Li 2015). Allowing a greater scope for the market, however, means reducing the scope of government and diminishing the power of the CCP. Moreover, improving the “vitality of the market” means strengthening the institutional infrastructure that supports a free-market system, including the protection of private property rights broadly defined to include a free market in ideas.

In thinking about the relationship between government and the market—or more fundamentally, between the individual and the state—it is important to recognize that the *modus operandi* of the state is *coercion*, while that of the market is *consent*. The basic issue is how to balance state and market so that individuals are free to choose while ensuring that government is limited to safeguarding life, liberty, and property.

One of the most powerful ideas in social and economic thought is that of a “spontaneous order” arising from the interaction of free individuals under a just rule of law. In 1776, Adam Smith argued that, if “all systems either of preference or of restraint” were “completely taken away,” a “simple system of natural liberty” would evolve “of its own accord.” Each individual would then be “left perfectly free to pursue his own interest in his own way, and to bring both his industry and capital into competition with those of any other man, or group of men,” provided “he does not violate the laws of justice” (Smith [1776] 1937: 651).

President Xi Jinping has said that China needs “to make good use of both the invisible hand and the visible hand” (Xi 2015). The problem is that the invisible hand doesn’t work well without the freedom that stems from widespread private property and limited government. That is why Wu Jinglian, one of China’s most respected economists and reformers, declared: “Only by matching the rule of law with the market economy can we achieve total success” (quoted in Fu 2005).

In this article, I discuss the major challenges confronting China as it marches ahead on the path to creating a harmonious and prosperous society, and the opportunities that will appear if those challenges

are met. In doing so, I consider the importance of getting the relationship right between the individual and the state, and the need for developing a free market in ideas.

## Challenges to China's Future Development

In December 2003, Premier Wen Jiabao gave an important speech at Harvard. He expressed optimism regarding China's future and remarked that the Middle Kingdom had "found the right path of development"—namely, "building socialism with Chinese characteristics." The essential nature of that path, he said, "is to mobilize all positive factors, emancipate and develop the productive forces, and respect and protect the freedom of the Chinese people to pursue happiness" (Wen 2003). Pointing to China's successful economic liberalization since 1978, he noted:

With deepening restructuring toward the socialist market economy . . . , there was gradual lifting of the former improper restrictions, visible and invisible, on people's freedom in choice of occupation, mobility, enterprise, investment, information, travel, faith, and lifestyles. This has brought extensive and profound changes never seen before in China's history [Wen 2003].

Wen attributed that success "to the freedom-inspired creativity of the Chinese people." However, he argued that to ensure future development, workers would need more capital, and that to attract sufficient capital, China would need more secure property rights: "Without effective protection of the citizens' right to property, it will be difficult to attract and accumulate valuable capital" (Wen 2003).

The 2008 global financial crisis put a brake on Wen's vision as Beijing engineered a massive "stimulus" program that favored large state-owned enterprises (SOEs). China's financial sector continues to be characterized by state-led credit allocation and financial repression. The lack of capital freedom and barriers to the free flow of information reduce the likelihood of having the renminbi (RMB) become a widely accepted reserve currency (see Prasad 2017). Meanwhile, Hong Kong—with its currency board, high degree of economic freedom, and sound rule of law—continues to have a substantial comparative advantage in the financial sector.

In November 2012, Xi Jinping became general secretary of the CCP and chairman of China's Central Military Commission, and in March 2013, he was "elected" president of the People's Republic of China (PRC). His avowed goals, as stated in his closing speech at the First Session of the 12th National People's Congress (March 17, 2013), are to "push forward the great cause of socialism with Chinese characteristics" and "achieve the Chinese dream of great rejuvenation of the Chinese nation" (Xi 2013).

The first sign of progress came in November 2013, following the Third Plenary Session of the CCP's 18th Central Committee, headed by Xi Jinping, when it announced the "Decision on Major Issues Concerning Comprehensively Deepening Reforms" (CCP 2013). The 60-point road map calls for reform on a broad front but with a focus on economic reform: "Economic system reform is the focus of deepening the reform comprehensively. The underlying issue is how to strike a balance between the role of the government and that of the market, and let the market play the decisive role in allocating resources and let the government play its functions better."<sup>2</sup> Resource allocation is to be improved by adhering to "market rules, market prices and market competition." Officials should "encourage, support and guide the development of the non-public sector, and stimulate its dynamism and creativity" (CCP 2013).

The new road map for reform also emphasized the importance of property rights: "Property rights are the core of ownership. We need to improve the modern property rights system with clear ownership, clear-cut rights and obligations, [and] strict protection." In that regard, SOEs will be allowed "to develop into mixed enterprises," and "a rural property rights transfer market" will be established to help ensure "the open, fair and procedure-based operation of rural property rights transfer." The *hukou* system will also be reformed by allowing "the eligible population to move away from agriculture and become urban residents." Finally, there will be further efforts to "improve the mechanism for market-based renminbi exchange rate

<sup>2</sup>As early as 1956, Gu Zhun, an economist working at the Chinese Academy of Sciences, recognized that, if China was to improve the allocation of its scarce resources, the market pricing system would have to supplant central planning (Wu 2005: 37–38).

formation, accelerate interest-rate liberalization, and . . . promote the opening of the capital market” (CCP 2013).

While the Central Committee’s road map is promising, the reality is that “if people are not allowed to freely debate how to reform the political system, then it will be impossible to develop the right ideas to implement this roadmap” (Zhang 2015: 38).

Although President Xi has called for further economic liberalization, he has done little to advance privatization, the rule of law, or limited government. Instead, he has focused on cracking down on any attempts to create a free market in ideas and seeks to strengthen large SOEs—by requiring that they operate on a commercial basis (an old socialist dream)—and plans to retain them as the heart of China’s socialist market economy (see Wei 2015).

At the 19th Party Congress in October 2017, President Xi linked the Chinese Dream of “great rejuvenation” to peaceful development:

The dream of the Chinese people is closely connected with the dreams of the peoples of other countries; the Chinese Dream can be realized only in a peaceful international environment and under a stable international order. We must keep in mind both our internal and international imperatives, stay on the path of peaceful development, and continue to pursue a mutually beneficial strategy of opening up [Xi 2017b: 22].

At the same meeting, he also declared: “Our efforts to build a country, government, and society based on the rule of law have been mutually reinforcing; the system of distinctively Chinese socialist rule of law has been steadily improved; and public awareness of the rule of law has risen markedly” (Xi 2017b: 3).<sup>3</sup> The “socialist rule of law,” however, is far removed from a liberal rule of law that protects persons and property from the heavy hand of the state. China has a dismal record in building a legal system that uses law to advance human freedom rather than suppress it.

The real challenge for China is to turn rhetoric into reality by allowing free expression. A competitive market in ideas would benefit Chinese culture by drawing on many minds—from both East and West. History has shown the failure of central planning and control

<sup>3</sup>For a detailed examination of Xi Jinping’s views on a socialist rule of law for China, see Xi (2017c).

in both the market for goods and the market for ideas. Silencing the voices of Chinese liberals—and blocking the transmission of Western ideas of limited government, separation of powers, and freedom under a just rule of law—will not “emancipate the mind” or create a harmonious society.

If Xi Jinping and the CCP were really interested in emancipating the mind and letting “a hundred schools of thought contend,” they could begin by recognizing that, long before Adam Smith, Lao Tzu recognized the importance of the principle of noninterference (*wu wei*) and the idea of spontaneous order. In Lao Tzu’s classic *Tao Te Ching* (chap. 57), the sage-ruler says: “Through my non-action, people are spontaneously transformed. . . . Through my non-interfering, people spontaneously increase their wealth” (Chang 1975: 143).

Chuang Tzu (Zhuangzi or Master Zhuang) also adhered to the idea that harmony is best achieved by leaving people alone to pursue their own interests. He believed that each individual is unique, seeks a better life, and is naturally inclined toward peace and order. He opposed forced order and adhered to the principle of freedom (Fung 1952: chap. 10). As Fung Yu-lan (1952: 229) writes, “Since good order is generally desired, one need only let things alone, and good order will result spontaneously. Thus Chuang Tzu, like Lao Tzu, advocated government through non-government.”

The Taoist view of freedom and order is in sharp contrast to Xi Jinping’s notion that “freedom is the purpose of order” (Xi 2015). Lao Tzu and Chuang Tzu’s views are consistent with western views of market liberalism, in which freedom is the essential means to an emergent or spontaneous order—not the purpose of order. Nobel laureate economist James M. Buchanan best expressed that idea when he wrote: “The ‘order’ of the market emerges only from the process of voluntary exchange among the participating individuals” (Buchanan 1982: 5).

If freedom is to result in order as opposed to chaos, there needs to be what F. A. Hayek called “rules of just conduct”:

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 [Hayek 1967: 162].

Like Hayek, the great legalist scholar Han Fei Tzu (3rd century, B.C.), thought that “order without direction” required firm rules to guide individual behavior. He accepted the Taoist notion of spontaneous order but emphasized that, given the nature of man, rules are necessary to make sure freedom leads to socially beneficial results by limiting the power of the state and ensuring equality under the law. Hence, he understood that without a genuine rule of law, China could not create a truly harmonious society.<sup>4</sup>

Xi Jinping draws on the Legalist School to justify using the force of law to rule people. In doing so, he ignores the fact that Han Fei Tzu sought to integrate Taoism with a *liberal* legalism and viewed law as an instrument for enhancing—not repressing—freedom.<sup>5</sup> It is therefore important to distinguish between “socialist rule of law” and Hayek’s “rules of just conduct,” which are designed to prevent injustice and support the emergence of a spontaneous order.

China’s challenge is to move from market socialism to market liberalism, or what I call “market Taoism” (Dorn 1998). China needs to return to its ancient culture and cultivate the liberal ideas of thinkers such as Meng Tzu (Mencius), Lao Tzu, Chuang Tzu, and Han Fei Tzu—all of whom recognized the importance of freedom in promoting a harmonious social order.

## New Opportunities in a Freer China

Opening to the outside world in 1978 has made both China and her trading partners better off. Replacing ideological struggle with peaceful development has created new opportunities for mutually beneficial exchanges. Individuals have much more personal freedom than under the disastrous policies of Mao Zedong. Nevertheless, economic reform has not resulted in a free market for ideas.

<sup>4</sup>For a discussion of Han Fei’s ideas and how they relate to “Great Good Government,” see Dorn (2016: 34–36, and the references therein). Also, see Schwartz (1985: 332–33, 341–45).

<sup>5</sup>Han Fei Tzu is often wrongly viewed as an authoritarian of the Legalist School rather than an advocate of market liberalism under a rule of law that prevents injustice. For example, Didi Kirsten Tatlow (2014), in an article in the *New York Times*, writes: “Mr. Xi has drawn on the teachings of Han Fei, the Legalist philosopher who advocated rule with an iron fist.” Also see Hilton (2015), who argues that Han Fei “saw the law not as a guarantee of justice but as a coercive instrument in a state in which the moral standards of the ruler were irrelevant.” For a counterargument, see Dorn (2015).

In response to the suppression of personal liberties during the Mao era, the 1978 Constitution of the People's Republic of China (PRC) guaranteed individuals "four big rights": "Speak out freely, air their views fully, hold great debates, and write big-character posters" (Art. 45). However, those rights were removed from the PRC Constitution in 1980. The constitution has been amended since that time to recognize the right to private property and pay lip service to human rights. It continues to be the case that all rights are granted and controlled by the state; there are no inalienable rights.

The absence of what Hayek (1960) called a "constitution of liberty" in China means there is still much uncertainty regarding the security of persons and property (see Pilon 1998). Removing that uncertainty would open new opportunities for the Chinese people. Indeed, if China embraced a genuine rule of law—that effectively limited the power of government, safeguarded private property rights broadly interpreted, and depoliticized economic relations—opportunities for mutually beneficial trade and investment would dramatically improve.

Innovation and entrepreneurial activity would flourish in a system of well-defined and protected property rights, and financial markets would deepen in an atmosphere of trust and the free flow of information—just as they have in Hong Kong. In such an environment, the RMB would no doubt become a major reserve currency and even reach a "safe haven" status.<sup>6</sup>

Whether those opportunities fully emerge will depend on political as well as economic reform. Both China and the United States need to support a rules-based international trading regime and respect the principle of nondiscrimination. A big first step would be for China to actualize the personal freedoms that are promised in its Constitution, beginning with a free market in ideas.

## Why China Needs a Free Market for Ideas

In 1825, James Madison, the chief architect of the U.S. Constitution, wrote, "The diffusion of knowledge is the only guardian of true liberty."<sup>7</sup> Nearly a century later, Supreme Court Justice

<sup>6</sup>Eswar Prasad (2017: chap. 7) has argued that, given China's current institutions, the goal of making the RMB a safe haven currency is a "mirage."

<sup>7</sup>Letter to George Thompson, June 30, 1825 (see Padover 1953: 337).

Oliver Wendell Holmes, in his dissenting opinion in *Abrams v. United States* (1919), argued for “free trade in ideas” and wrote: “The best test of truth is the power of the thought to get itself accepted in the competition of the market.” In 2012, Ronald Coase and Ning Wang introduced the term “market for ideas” (*sixian shichang*) to the Chinese. They argued:

The lack of a free market for ideas . . . has become the most restrictive bottleneck in China’s economic and social development. Ever since the start of economic reform, the Chinese government has been persistently calling for the “emancipation of the mind,” but nothing is more effective than an active market for ideas in freeing people’s minds [Coase and Wang 2012: 199].

A country that does not allow its people to speak freely loses legitimacy and trust. People cannot be confident that the discretionary power of government will not be used against them for even the slightest criticism of the regime. When the ruling party has a monopoly of power and there is no opportunity for honest feedback from the people or press, then the probability of permanent errors is high. That is why Ning Wang (2017: 149) writes: “The ultimate success of China’s search for economic prosperity, cultural renaissance, and a ‘peaceful rise’ depends, in large part, on whether a free market for ideas can reemerge and flourish in China.”

Zhang Weiyong, a professor of economics at the National School of Development at Peking University, has argued that in order to understand institutional change, one must go beyond simple self-interest models and examine the role of ideas and leadership (Zhang 2015: 4). In the case of China, Zhang (2015: 15) notes: “Without the right ideas and strong leadership, it would have been impossible for the openness policy to succeed.” He gives many examples of the role of ideas and leadership since 1978, and he points to “six traps of wrong ideas” that must be rectified if China is to become “a liberal society.”

One of those traps is to think that “economic liberalization can continue without political reform.” That idea is wrong because it ignores the fact that, “as people have wealth to protect and innovation becomes crucial for growth, the rule of law becomes a necessity.” Moreover, after 40 years of economic reform but little political reform, “the Chinese government needs new legitimacy for ruling

the country.” In particular, “If the government cannot protect people’s basic human rights, including the freedom of speech, press, and religion, its legitimacy will be seriously challenged” (Zhang 2015: 30–31).

Another wrong idea is that “the status quo is good for vested interests.” That may be true in the short run, according to Zhang, but not in the long run. The reason is evident:

While the vested interests enjoy privileges, they lack the basic human rights such as free speech and personal security, just like other ordinary people. Even though privileges give them better opportunities to be wealthy and powerful for the time being, the lack of human rights implies that they are always at political risk—neither their personal freedom nor their property is secure. Under the current system, anyone can be arrested without going through a legal procedure, regardless of seniority [Zhang 2015: 31–32].

China’s future will depend on replacing wrong ideas with correct ideas—that is, those that are consistent with the pursuit of happiness under a just rule of law that limits the power of the state and protects individual rights.<sup>8</sup> There are many good ideas in the road map laid out at the Third Plenum of the CCP’s 18th National Congress. However, as Zhang (2015: 38) notes: “If people are not allowed to freely debate how to reform the political system, then it will be impossible to develop the right ideas to implement this roadmap.” By cracking down on the market for ideas, President Xi is missing the opportunity for real reform.

The value of free speech is that it allows people to improve institutions by pointing out weaknesses, which can then lead to improvements: “Transparency of public institutions, the right to free expression, and an unfettered media are all necessary for building confidence. They do this not by emphasizing strengths, but by making weaknesses and faults in the system obvious” (Prasad 2017: 156). Chen Zhiwu, a professor of finance at the University of Hong Kong,

<sup>8</sup>Zhang (2015: 36) states: “The future of China’s reform will depend on the kind of ideas and leadership the new leaders, particularly General Secretary Xi Jinping, have. To succeed in a peaceful transition to a liberal society, China must get rid of the wrong ideas.” To do so, China needs “to create a marketplace for ideas. It is the free competition in the academic market and the debate of different opinions, beliefs, theories, and ideologies that produce new and right ideas.”

agrees: “A free press can not only provide independent information, but also act as a corrective mechanism for the economy in a way that the government cannot. Thus, media freedom is not only politically necessary, but also good for growth and job creation” (Chen 2005).

The free flow of information is particularly important in the service sector, which deals with intangibles and requires complex contracts that rely on timely, accurate, and diverse information. Without an open market for ideas, the development of financial and other services will be hampered. Confidence and trust are important elements in any transaction but particularly so in financial transactions. As Chen (2005) argues,

Press freedom facilitates service development by reducing information asymmetries among transacting parties, bringing confidence to the marketplace. Unbiased information enhances trust, which is fundamental to the deepening of a service market. . . . Censorship limits the supply of useful information and distorts the information available in the marketplace, thereby hindering the development of markets—especially financial markets.

China benefits from having access to Hong Kong’s financial markets based on the rule of law, an independent judiciary, and a free market in ideas. If China is to advance its own service sector, it would do well to learn from Hong Kong.

A free market for ideas is important for economic development but even more important for human progress. In the words of Nobel laureate Liu Xiaobo: “Freedom of expression is the foundation of human rights, the source of humanity, and the mother of truth. To strangle freedom of speech is to trample on human rights, stifle humanity and suppress truth” (Liu 2009).

## Conclusion

China has accomplished much in its 40 years of reform and opening to the outside world, but it has a long way to go in terms of both economic and political freedom. Beijing and the CCP have placed stability above freedom, but without freedom there can be no lasting stability. The lack of limited government under a genuine rule of law and the absence of a free market in ideas endanger China’s future development.

The challenges facing China include hostility over its trade policies, which restrict market access, favor SOEs, and compromise intellectual property rights; a weak legal system that favors special interests and is dominated by the CCP; slowing growth and rising debt; and a constitution that makes empty promises to safeguard human rights and free expression.

Overcoming those and related challenges will determine the range of opportunities open to the Chinese people. Especially important will be whether China relaxes its strict controls on the free flow of information and creates a free market for ideas.<sup>9</sup> The crackdown on think tanks like the Unirule Institute, which stands for limited government and the rule of law, is in stark contrast to Hong Kong, which supports a free market in both goods and ideas. That is why Hong Kong, with its big market and small government, is out-competing the mainland in the provision of financial services.

The main lesson for China's future development is clear: "When the market for goods and the market for ideas are together in full swing—each supporting, augmenting and strengthening the other—human creativity and happiness stand the best chance to prevail" (Coase and Wang 2012: 207).

President Xi has argued that China

must have the determination to get rid of all outdated thinking and ideas and all institutional ailments, and to break through the blockades of vested interests. We should draw on the achievements of other civilizations, develop a set of institutions that are well conceived, fully built, procedure based, and efficiently functioning, and do full justice to the strengths of China's socialist system [Xi 2017b: 18].

He has also said, "We need to make use of the great wisdom accumulated by the Chinese nation over the last 5,000 years" (cited in Page 2015).

Opening the door to the study of Western and Chinese liberalism—especially the ideas of spontaneous order, limited government, and the rule of law—would be a giant step toward ensuring "peaceful development" and realizing the "Chinese dream" of social and economic harmony.

<sup>9</sup>Yuen Yuen Ang (2016: 249) has argued that "China needs to find new sources of adaptability and innovation" to realize "the immense creative potential of Chinese society"—and that "academic freedom is a clear place to start."

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