



## Markets and Marxism: USA, USSR and China

Professor Martin Daunton

31 October 2023

In 1989, two major events shaped the modern world:

- The brutal suppression of protests in Tiananmen Square on 4 June 1989 and the reassertion of authority of the Chinese Communist Party. Deng Xiaoping had embarked on economic reform, but the party would remain in control to manage transition to an economy with market features. Deng called it 'socialism with Chinese characteristics.' The result was unprecedented rates of economic growth and improvement in the welfare of many Chinese people.
- Fall of the Berlin Wall on 9 November 1989. General Secretary Mikhail Gorbachev did not intervene and in 1988, he had made a decision that Deng thought disastrous: loosening the hold of the Communist party. Economic reform continued as 'shock therapy' - a swift conversion from a planned to market economy. The outcome was falling standards of welfare for many Russians and vast riches for others, with the emergence of a 'kleptocracy'.

The discrepancy between per capita GDP Russia and China narrowed – Russia stagnated as China surged ahead.

### Purchasing power parity by GDP per adult at constant 2021 Euro, 1960-2020

Year	USA	Russian Federation	China
1960	23,876	-	1,768
1970	31,545	16,301	2,002
1980	35,446	21,232	2,398
1990	42,853	22,918	3,302
2010	56,239	22,243	11,172
2020	61,443	25,856	19,729

Table 1. World Inequality Database at <https://wid.world/data>

President Bush and Gorbachev met in Malta in December 1989 and announced the end of the Cold War. The American political scientist Francis Fukayama thought – to use the title of his book of 1992 – that this marked The End of History: the demise of the Soviet Union meant “not just ... the passing of a particular period of post-war history, but the end of history as such: that is, the end-point of mankind’s ideological evolution and the universalization of Western liberal democracy as the final form of human government”. This was an absurd claim in a moment of seeming triumph. But this triumph over Communism could not have been predicted even a few years earlier when the world was gripped in a battle between different economic and political systems and visions of modernity – a clash between market economics and Marxism, not only between the west and Soviet Union, but also between the Soviets and China.

What were the different approaches of the US, Soviet Union and China during the Cold War?

## Visions of Modernity

The United States, of course, opposed Marxism and hoped to block its expansion and to extend market capitalism in the Third World.

American thinking rested on the belief that traditional societies were inert, inflexible, superstitious, wary of change, dominated by agrarian elites, without a powerful middle class, relying on a simple economy with limited technology, and fatalistic subservience to nature. A modern society was defined as being like the United States – flexible and adaptable, welcoming change, outward looking and rational, with a complex economy based on private ownership and enterprise, division of labour, willingness to subjugate the natural world. Needless to say, both of these visions lacked real insight into the societies they purported to describe – but they shaped American policy.

To many influential figures in the United States, the greatest danger came at the point of transition from a traditional peasant society to modernity which could be exploited by Communists. Above all, this was the claim of the Center for International Studies at the Massachusetts Institute of Technology, directed a former assistant director of the CIA which contributed to its funding. The most important member of the Center was the economic historian Walt Rostow, an adviser to both Presidents Kennedy and Johnson, and a hawk in the Vietnam war. His most famous book was *The Stages of Economic Growth: A Non-Communist Manifesto* (1960) which offered an alternative path to modernity from the Soviet Union and the Communist Manifesto of Marx and Engels. The book generalised from British economic history. The stages to which he referred were unlike Marx's stages from feudalism/landed aristocrats to bourgeois capitalists, the dictatorship of the proletariat, and finally socialism, driven by class conflict and the internal contradictions of the economy. Rather, Rostow's stages ran from the propensities or preconditions to the next stage was take-off into self-sustained growth caused by a rise in capital formation and a leading sector. Like a jet accelerating down a runway, these forces could power the economy into flight, a flight that was first achieved in the British industrial revolution. Unlike the story of immiseration and exploitation of workers in the Communist Manifesto and *Das Kapital*, the outcome was a drive to maturity and finally high mass consumption as in modern America.

In Rostow's view, the dangerous stage was before the take-off as traditional society broke down and before economic growth delivered welfare gains. In his view, Communism was "not the wave of the future; it is a disease of the transitional process which well-trained, well-organized cadres seek to impose on societies at the early stages of modernization." Two things followed:

- Complete the take-off into self-sustained growth as quickly as possible to deny Moscow and Beijing their "dangerous mystique" of transforming underdeveloped countries. It meant an active programme of economic aid until self-sustained growth was achieved.
- In the short run, before the standard of living was improved by democratic capitalism, it was vital to contain Communism by military action. Hence, Rostow's hawkish stance in Vietnam.

Against this American strategy, both China and the Soviet Union sought influence in the Third World, but with different ideological assumptions.

The Soviets concentrated on a critique of capitalism rather than colonialism. The USSR was an unusual entity. It lacked a defined geographical area or identity and was a collection of republics, each with a titular nationality and some with national minorities in autonomous areas. In theory, Russia was only another republic with its own autonomous areas such as the Chechens. The status of a patriotic Soviet citizen was combined with a national identity. The Tsarist territorial expansion – so it could be claimed – had not been imperialistic conquest but rather voluntary annexation to save central Asia from the British. This view of history allowed the Soviets to argue that it was a non-imperial power that accepted local cultures and identities. It allowed Khrushchev to define the Soviet Union as Eurasian, multicultural, a successful model of how to overcome feudal rule in the Third World.

Khrushchev's aim was to export Soviet modernity based on large-scale investment and economic planning in alliance with bourgeois nationalists such as Kwame Nkrumah in Ghana or Nasser in Egypt, building on their role in securing independence. Soviet involvement usually relied on pragmatic assessment of costs and benefits of trade – such as cocoa in Ghana. Less weight was given to an ideology of anti-colonialism.

China took a different line. Mao was more interested in revolutionary movements and support for guerrillas against colonialism. Unlike the Soviets, China appealed to the Third World as a victim of racism and imperialism. As we will see, Mao looked to creative use of disorder at home, and used this strategy overseas through support for peasantry and violence. Mao rejected peaceful transition by a national bourgeoisie as “preposterous” and instead looked to a culture of insurgency. China could not afford to support soviet-style industrialisation as a route to modernity – and in any case it was not a strategy that was pursued at home.

Soviets did, it is true, on occasions support insurgency to counter the Chinese – but as China descended into internal chaos in the cultural revolution, Beijing lost leverage with governments in the Third World. As a result, the Soviets had less need to compete. Maoism continued as guerilla insurrection in disaffected rural areas such as the Shining Path in Peru – a movement led by Maoist intellectuals against American and Soviet imperialism that took control of rural areas.

The global Cold War was a battle between different views of modernity and economic systems. In the 1950s and 1960s, it still seemed that the Soviet Umon was a real threat to the United States: it had won the space race and was a technologically advanced military power. Khrushchev hoped to overtake the United States as an industrial power within 15 years – and the claim was treated as serious in Washington. In 1957, Mao countered the ambition of Khrushchev to overtake the United States: he aimed to overtake Britain – still the world’s second largest economy – within 15 years. The Soviet Union and China took very different routes in their attempt to catch up with the major capitalist economies. In the Soviet Union, Marxism collapsed in the attempt to create markets. In China, markets remained under the control of Marxists. How did this divergence take place?

## The Soviet Union: From Command Economy to Kleptocracy

In 1929, Stalin announced it would be the year of the “great break-through”: “We are going full steam ahead to socialism along the road of industrialisation, leaving behind our traditional Russian backwardness. We are becoming a country of metal, a country of the automobile, a country of the tractor.” It meant “a tremendous break-up of the old and a feverish construction of the new.” It would show that North American capitalism was not the future, replacing the chaos of markets and under-consumption. The breakthrough involved:

- Collectivisation of agriculture to become more efficient, to feed cities and release labour for industry. Individual peasant households were replaced by large collective farms. In 1928, 96.2 per cent of sown area held by peasants; by 1940, down to 9.5 per cent and collective farms to 78.2 per cent and state farms 8.8 per cent.
- Large-scale heavy industry and machine building rather than consumer goods. Stalin aimed to prevent ‘capitalist encirclement’. Industrial cities were constructed, such as Magnitogorsk which was planned as the world’s largest steel works.
- Highly centralised: large plants specialised in particular products, spread between republics so that the final product relied on bringing together materials from across the Soviet Union. These materials were allocated by planners rather than by market and price signals. Output targets were set with payment against the plan, regardless of quality or consumer demand.
- The economy was closed with international trade limited by the system of state trading: without market prices, it meant a form of barter or bilateral exchange. The main exception was export of oil and gas which became increasingly important.
- A new type of Soviet citizen was to be created expressing patriotic, revolutionary duty.

Soviet production rebounded after 1945 but the economy was even more militarised, with tighter centralised control, growing use of forced labour, closed towns for research. Political authority vital to the functioning of the command economy – if authority were weakened, it would be difficult to maintain even the limited efficiency of the system.

The command economy did not operate as theory suggested in delivering efficiency, removing wasteful competition, and meeting needs in a rational way. By the final decades of the Soviet Union, it was facing serious problems:

- Planners did not know the preferences of consumers. There was a close link between consumers and producers in the defence sector – hence Soviets could win the space race but not supply basic consumer

goods. Note the kitchen debate between Nixon and Khrushchev in 1959.

- Managers had little incentive to be efficient. Success rested on meeting the target, not on quality and profitability. Priority was given to accumulation over consumption. Repression and restriction of the lives of workers meant there was little motivation for workers or for managers.
- Workers depended on the factory for housing, health care, and access to scarce goods. Workers colluded with managers who ignored their absenteeism, alcoholism, poor work quality, on condition that they 'stormed' to meet targets at the end of the year. Managers stock-piled materials and employed more workers so that they could meet the target.
- Weakness of the official economy to supply consumer goods and inputs into production compensated by an informal economy – from a few goods pilfered by workers to large-scale corruption. State factories used agents to swap goods outside the planning system; individuals exchanged goods and favours such as access to university or medical care. This System of “*Blat*” rested on reciprocity and trust. Although it was outside planning, it was not like a market economy.

This system was close to collapse when Gorbachev became General Secretary in 1985. He tried to introduce reforms in the system – perestroika. It did not work. For a representation of this system in decay, see Adam Curtis's BBC documentary of 2022 using contemporary footage – *Russia 1985-1995: Trauma Zone*.

What did Gorbachev attempt?

- Use of computers to provide more data to make planning work – failed disastrously.
- Lower subsidies to state enterprises which were now to finance their activities by setting production targets and selling surplus beyond their commitment to the state. But managers had no experience in deciding what to produce or how to set a price, or ensuring labour turned up and produced goods of sufficient quality. There was no functioning market to provide information.
- Wage reform to overturn informal understandings. Wage differentials were increased, and jobs regraded (often downgraded); alcoholism was attacked in return for a promise of higher standard of living, participation in the enterprise and political liberalisation.

The result was that established ways of life and deals between managers and workers were disrupted, but with shortages of consumer goods, inflation, discontent. The economy was stretched by a fall in earnings from oil, and by the costs of war in Afghanistan, the arms race with the United States, and the Chernobyl disaster of 1986. State finances were collapsing; there were high levels of illicit alcohol consumption; demands for higher wages; a failure of coordination between enterprises. The old system of planning and favours was collapsing without a market economy to replace it.

In 1988, Gorbachev decided to end the Communist party's monopoly of power to secure support for reform. The Congress of People's Deputies would reserve a third of seats for Communists with the rest open to contest. Gorbachev hoped to create popular support for his reforms and overcome the hostility of senior officials. Elections in March 1989 did not deliver what he hoped: he was criticised both by Communists who remained powerful in Congress and by liberal reformers. The elections in the republics empowered separatist – the Baltic republics and Ukraine declared independence. The republics – including Russia – failed to pay taxes to the Soviet Union, and the supply chains in the integrated Soviet economy were threatened – a problem for Ukraine, the second largest industrial economy in the Union.

Hardship caused by economic reform led to discontent, demonstrations in Moscow in February 1990, followed by attempted coup in August 1991 and rise of Boris Yeltsin, the president of Russia at the expense of the Soviet Union.

Essentially, Russia defeated the Soviet Union which was dissolved in 1991 and replaced with a loose confederation of independent states.

Yeltsin proceeded with the economic reforms started by Gorbachev. His approach was 'shock therapy' to force a swift transition to a market economy. Yegor Gaidar was in charge of economic reform, and he later explained the strategy: "There wasn't much choice: it was either constantly increasing chaos or, with no preparation whatsoever, an immediate start-up of the market mechanism – with the understanding that the parts required for it to function normally would be built in later, as we went along". He thought it impossible to pursue a dual-track approach of establishing a market economy alongside the old command economy. A complete and sudden switch was needed.

The market reformers worked with the IMF and World Bank. Yeltsin secured membership of the IMF in 1992. At this point, the Washington-based international institutions were ideologically committed to encouraging market and financial liberalisation. The managing director of the IMF, Michel Camdessus, visited Moscow in 1990 and recommended spending cuts, tax increases, price liberalisation and privatisation. It was not necessarily an outside imposition, for Gaidar and other reformers favoured this approach. The reason was in part political: Gaidar realised that ‘shock therapy’ was needed to stop the old guard regaining authority. Also, the collapse of the Soviet Union had disrupted supply chains and failures of the command economy seemed to demand immediate price liberalisation in 1991 and privatisation in 1992.

Privatisation was politically risky. There were different stakeholders in state enterprises – workers had their social welfare as well as wages; managers saw the plants as their own; local government needed revenue; citizens as a whole had a claim to ownership. Gaidar’s solution was to offer vouchers or privatisation cheques to all citizens to create widespread ownership – they could be used to buy shares in state companies. These vouchers were tradeable and were bought by more financially aware Russians who took control of state enterprises and made huge profits. Meanwhile, ordinary Russians suffered from a loss of welfare, higher taxes, lower food subsidies. Failure to stabilise the currency led to hyperinflation that reached 1,354 per cent by the end of 1992.

Gaidar was replaced by Viktor Chernomyrdin, the chair of Gazprom. Yeltsin needed support from business for elections in 1996, and he embarked on further privatisation in 1995 in the form of ‘loans for shares.’ If loans made to the state were not repaid by September 1996, creditors would secure shares. Loans were made by banks controlled by oligarchs who secured more state assets.

The outcome was not as hoped by Gaidar – democratic market capitalism. It was a ‘capture economy’ or oligarchic kleptocracy:

- State lost from plundering by oligarchs.
- Citizens lost welfare.
- GDP fell by a third in the early 1990s.
- Unemployment 22 per cent in 1998.
- Male life expectancy fell from 64 in 1991 to 57 in 1994.

What responsibility falls on the IMF for pushing market and financial liberalisation? It was easy for Russians to blame the IMF for undermining Russian sovereignty – though the policies largely emerged from internal dynamics. Although the IMF was wary about removing conditions attached to its loans and was aware of mounting problems, the Bush administration pressed the IMF to concede on strategic grounds. Nevertheless, the IMF was a captive of its ideology of market liberalisation:

- It did not oppose the loans for shares scheme
- It contributed to the crisis by refusing to replace the eider rouble zone with a Russian national currency
- It did not argue for debt rescheduling.

In 1997, Camdessus saw the dangers of control by oligarchs and the IMF turned to good governance. It was a good idea that came too late now that the oligarchs were entrenched. And the IMF continued to press for more liberalisation by removing capital controls– and astonishingly congratulated itself in 1998 that “the most important battles in securing macro-economic stabilization and creating a market economy have been won”. Reality was different: capital flowed in, removing the need for budget restraint and tax reform. In 1998, a financial crisis led to a collapse of the rouble.

Shock therapy had, it is true, worked in Poland but the circumstances were different. Jeffrey Sachs, the American economist who played a large role there and became an adviser to the Russian government, realised there were greater difficulties in Russia:

- Poland secured financial assistance for debt rescheduling, currency stabilisation and a social safety net. This did not happen in Russia. It was opposed by the IMF. Further, Germany was willing to support Poland, but was more concerned with costs of reunification. The American administration looked instead to contain Russia by military superiority.
- Poland could more easily turn to western European markets and made links with the German economy.

In 2000, the new president of Russia – Vladimir Putin – seemed a welcome replacement for Yeltsin’s chaotic government. He seemed to be engaging with the G8 of major economies: there were hopes that Russia was joining a liberal global order. The economy grew up to the global financial crisis of 2008. But as we now know, Putin turned to Russian nationalism to roll back the collapse of the Soviet Union and independence of Ukraine in 1991. He took over some private companies like Yukos oil; and state companies like Gazprom gave him large profits for the state and his own personal benefit. Russia was heavily dependent on oil and gas revenue which comprised 51.3 per cent of state revenues in 2014. This ‘oil curse’ constrained diversification of the economy.

Putin had learned from the crisis of 1998 that macro-economic stability was needed, but it went with a state-dominated kleptocracy answerable to him and relying on authoritarianism to survive. Putin could not rely on prosperity for legitimacy and turned to anti-democratic Russian nationalism.

The question now is whether Putin’s regime can survive, with pressure on the rouble and mounting costs of the war. Could there be another crisis as in the last days of the Soviet Union? History has certainly not ended with the triumph of democratic capitalism – and as China shows, authoritarian capitalism has been successful in delivering growth. How did China manage to transition to markets with Marxism?

## **China: Socialism with Chinese characteristics**

The Communist Party came to power in China in 1949. Under Mao, China experienced three disasters: the Great Leap Forward, the Great Famine, and the Cultural Revolution. What it did not experience was Soviet-style central, command economy with heavy industry and large collective farms. Mao’s monstrous rule had the unintended consequence of allowing his successors to adopt a more flexible approach to reform than in the Soviet Union.

Marx, Lenin, and Stalin viewed peasants as ‘potatoes in a sack’, with the revolution coming from the urban proletariat. By contrast, Mao’s power rested on the countryside. He believed that wisdom resided in the rural masses and the experiences of the People’s Army in its rise to power, rather than technical experts and intellectuals who needed to be re-educated in the fields. To quote Mao, “The humblest are the cleverest, the privileged are the dumbest”.

He launched the Great Leap Forward in 1958 – what he called a “rash advance”: Build dams, divert rivers – but Mao paid little attention to technical experts, mainly Soviets from whom Mao split. Thousands of people with handcarts were diverted from agriculture to construct poorly designed, wasteful schemes. For example, the plan to divert the Tao River from the south to the arid north meant that 3.4 million workers or 70 per cent of the workforce of Gansu were diverted from agriculture to a fantastical scheme that was abandoned in 1962.

He rejected central planning and relied on local party cadres, using local initiative to create self-sufficiency. Mao feared hostility from both the Soviets and US, so he favoured self-sufficient regions, a cellular economy with each region able to operate independently in the event of war. Mao’s strategy was different from Soviet Union where the economies of republics were integrated in a plan which removed their ability to compete; each concentrated on particular goods that were supplied across the Soviet Union. In China, regions were less economically integrated but there was – again unlike the Soviet Union – a stress on a single Han identity.

He did not force rapid growth of heavy industry in capital intensive plant but preferred small-scale labour-intensive industries in the countryside. The slogan was “Every household a factory, every home ringing with a ding-dong sound”. The result was small backyard furnaces, again diverting labour from agriculture for inefficient production of poor-quality steel.

Collectivisation, bringing farmers together in large units where rigidly organised. Workers were under strict discipline – what an East German called Kasernenkommunismus (Communism of the barracks), a term coined by Marx to criticise advocates of authoritarian collectivism. Directed by inexperienced cadres, using schemes such as deep ploughing that destroyed the topsoil or close cropping. The schemes were expected to increase yields in an ‘exaggeration frenzy’ as each level passed on ever-more implausible figures. The misplaced concern was what to do with the extra food.

The reality was huge costs for limited or no increase in production, with ecological disaster and devastating famine that led to between 30 and 60 million excess deaths between 1958 and 1962. Mao’s response was that “when there is not enough to eat people starve to death. It is better to let half the people die so that the

other half can eat their fill". Despite his lack of concern, senior officials admitted problems by 1961, with the blame placed on how the plans were executed rather than on Mao.

Deng Xiaoping, at this stage the secretary general of the Communist Party, proposed returning land to peasants. Mao feared a loss of influence and launched the Great Proletarian Cultural Revolution in 1966 to remove "a bunch of counter revolutionary revisionists". He attacked the upper level of the party and bureaucrats, shifting power to the localities, using populists' language to turn masses and Red Guards against officials who were publicly humiliated, including Deng who was purged as a leader of the "capitalist roaders". Mao was using "nationwide chaos" to create "greater order throughout the land" by "roasting the bureaucrats for a while without scorching them". Predictably, this strategy led to chaos rather than order, with different factions fighting against each other, and with the People's Liberation Army drawn in to reimpose order. Millions more people died in the Cultural Revolution.

In 1976, a power struggle took place. When Premier Zhou Enlai died in January, the radical Gang of Four tried to continue Mao's policies in opposition to reformers led by Deng who had been rehabilitated. Mao died in September and Hua Guofeng, premier from 1976 to 1980, secured support from the army to reimpose order and arrest the Gang of Four.

Hua took a cautious approach. He obtained some modern foreign technology by purchasing entire new factories, paid for by export earnings from natural resources. He did not wish to expose Chinese industry to the world economy, and he favoured central planning and bureaucracy in place of localism, more on the lines of the Soviets. His approach did not work. Buying modern technology 'off the shelf' was not suited to Chinese conditions, and there were insufficient foreign reserves to cover the costs.

Although he never held a top position of premier or chairman of the party, in December 1978 Deng became in effect the most powerful figure in the Chinese government, alongside Zhao Ziyang who was Hu's successor as premier from 1976 until 1987 and then General Secretary until the Tiananmen Square massacre in 1989. Zhao had been disgraced in the cultural revolution before re-emerging as party secretary in Sichuan, where he gave more freedom to household production – a line he continued to pursue on his move to Beijing. Zhao has been written out of the official Chinese account of economic reform, along with Tiananmen Square. The credit has been given to Deng. In reality, Zhao was just as important and willing to push reform further than Deng. These two men have been termed 'marketeters'.

Deng saw that the Cultural Revolution had harmed scientific and technical improvement. He adopted a new approach from 1978. His aim was 'socialist modernisation' based on four cardinal principles:

- Socialist road
- Dictatorship of the proletariat
- Leadership by the party
- Following the correct path of Marxism-Leninism and Maoism

What did these general principles mean in practice? Deng saw that China lagged because of imperialism and feudalism, not because socialism was inferior to capitalism. It was necessary to use capitalist methods of profits, incentives, markets, and technology to create the material base for a socialist society. In his famous remark, "It does not matter if the cat is white or black; so long as it catches mice, it is a good cat". China needed a strong economy if it was not to be subjected to domination, so that "The purpose of socialism is to make the country rich and strong". At the December 1978 meeting of Central Committee, he urged: "Let us advance courageously to change the backward condition of our country and turn it into a modern and powerful socialist state". Development was the task – and any opposition was an opposition to socialism. The aim was to use capitalist methods without creating a bourgeoisie who would engage in corruption and profiteering. "There is no way by which capitalism can ever eliminate the extraction of super-profits by its millionaires or ever get rid of exploitation, plundering, and economic crises. It can never generate common ideals and moral standards or free itself from appalling crimes, moral degradation, and despair". This was socialism with Chinese characteristics.

Zhao went even further. In 1984, he made an ambiguous speech to the politburo that "spontaneous market forces" should only apply to a few sectors – but also that it was no longer true that "planning is number one and the law of value number two" – the implication being that prices should be determined by supply and demand. In 1987, Zhao came close to arguing that anything that led to growth was, by definition, socialist: the central task in the 'primary stage of socialism' was economic development before mature socialism was feasible. Hence "whatever is conducive to the growth [of the productive forces] is in keeping with the fundamental interests of the people and is therefore needed by socialism... Whatever is detrimental to this

growth goes against scientific socialism and is therefore not allowed to exist.” Inflation caused by the creation of market alongside controlled prices should be tackled through growth.

On two occasions, in 1986 and again in 1988, more radical “marketeters” came close to shock therapy of rapid price reform and ending state ownership. They were concerned that the dual track approach of price controls allowed officials to exploit the price differences for their own benefit. In both cases, they pulled back. The dangers were clear in inflation and protests – above all at Tiananmen Square in 1989.

The alternative proposed by “balancers” or “adjusters” such as Chen Yun – a leading figure in the party. Chen was a reformer but stressed containment of markets within the plan: “One cannot hold a bird tightly in one’s hand without killing it. It must be allowed to fly, but only within its cage. Without a cage, it would fly away and become lost...[R]egulation of economic activity by the market must not entail abandonment of the orientation provided by the plan.” As he said in 1980, his aim was “to start with experiments at selected points and to draw lessons from experience at the right times”. It was “groping for stones to cross the river. In the beginning, steps must be small, walking slowly”. Chen feared that swift reform would undermine “socialist spiritual civilisation” which led to campaigns against corruption and materialism. He also thought that loosening price controls with alongside market liberalisation would lead to inflation, social unrest and disruption of the countryside. He favoured a dual track approach of price controls and planning alongside a liberalised market, with austerity to repress inflation rather than Zhao’s reliance on growth. He walked out of Zhao’s speech in 1987.

There were major challenges to reform in 1989 as a result of protests at Tiananmen Square. The protests were suppressed. Zhao was disgraced for failing to take a hard line and he spent the rest of his life in house arrest. Deng, who was not willing to undermine party control and accepted suppression of the protests, survived. Chen and the balancers seemed to be in the ascendant. But Deng fought back in the Southern Tour of 1992 where he called for renewed market reform, arguing that China “must not be like a woman with bound feet” but must “stride boldly forward”. He argued that market economies were not necessarily capitalistic and planning not necessarily the same as socialism – both were “simply stepping-stones to universal prosperity and richness”. He combined pragmatic economic reform with hardline authoritarianism. Economic growth would reduce demand for political change, and in meantime authoritarianism could be used to complete reform. Chen had less support in the regions, and the next generation of leaders were protégés of Deng who had contacts with western economists and businesses.

What were the specifics of the approach adopted by Deng and Zhao?

The structural context gave them room for manoeuvre. The Great Leap Forward, famine and Cultural Revolution meant small-scale units rather than the massive heavy industries of the Soviets under Stalin. The cultural revolution undermined the collective or communal approach and empowered peasant households. Frank Dikotter refers to a silent revolution in the countryside: ‘Cadres in the countryside were defenceless against myriad acts of quiet defiance and endless subterfuge as people tried to sap the economic dominance of the state and replace it with their own initiative and ingenuity’. The shift to individual household responsibility started from the late 1970s and was virtually complete in early 1980s. Land remained in collective ownership but was farmed by individual peasant households. It was not accepted – as many western economists insisted – those markets required private property rights. The agricultural reforms solved the grain shortage and allowed movement of population to cities.

There was scope for local enterprise in Town and Village Enterprises. Communes were abolished in 1982 and their workshops became TVEs. Deng remarked in 1985 that “if you want to bring the initiative of the peasants into play, you should give them the power to make money”. He rejected the claim of Chen that this was against socialism: in *Das Kapital*, Marx referred to employers of eight people exploiting workers, so a household head with seven workers was not an exploitative capitalist. This limit was soon breached – in 1987 allowed to employ more than seven workers. TVEs were central to transformation: by 1996, there were 23.4 million TVEs employing 135.1m workers. Some were owned collectively, but the largest group were household enterprises.

Meant opening the country to the global economy, but within limits to preserve national sovereignty. As Deng put it, “no country can now develop by closing its door. Isolation landed China in poverty, backwardness, and ignorance.” Zhao called for the party to “abandon once and for all the idea of self-sufficiency” and to use trade to overcome technological deficit. China needed foreign technology and ideas, not by buying entire factories. To Zhao, the solution was foreign direct investment by inviting multinationals to run factories, ideally through joint ventures which would allow the Chinese to learn and would create export capacity which would earn foreign exchange for more technology. Joint ventures allowed technological transfer and developed



exports but allowed the Chinese government to keep control of foreign investors and limit the sectors in they could participate.

Also, Special Economic Zones on the coast, legally and physically separate from the rest of China, integrated into the global economy, open to foreign investment and trade. The domestic and international sectors of the economy were distinct, with interior regions protected. Combining foreign investment with national sovereignty was critical. Deng remained anti-imperialist, and wanted to ensure that power did not pass to foreign investors and multinationals with their “external decadent ideologies.” “While pursuing the policy of opening up to the outside world, we must stick to the principle of relying mainly on our own efforts”. He stressed that the socialist state could control foreign investors, against the concern of Chen that SEZs were ‘countries within the country’ that were too close to the nineteenth-century concessions.

Did not need to rely on foreign capital for development: China had an extremely high domestic savings rate, partly a result of weak social security with many urban residents lacking benefits which were tied to their rural village through the hukou system of household registration. With interest rates below inflation, savers lost, and business and government gained.

The economy could ‘grow out of the plan’ – or given that the planned sector remained the same size, ‘grow into the market’. Dual track approach was more possible than in the Soviet Union. In the late 1970s, around 80 per cent lived in the countryside and only about 20 per cent worked in state owned enterprises, compared with 90 per cent in the Soviet Union. Growing into the market in China did not entail such a high level of disruption of the controlled sector as in the Soviet Union where all elements of the command economy were so intertwined that it was necessary to destroy the system before creating a market economy.

The cellular economy meant there was the possibility of regional competition. Local experiment sifted success from failure, and allowed deniability in Beijing when things did not work. It was a ‘regionally decentralised authoritarian system’. Local leaders could experiment provided they did not blatantly violate Communist principles and remained answerable to the party. Local leaders had an incentive to improve welfare to maintain social peace – and they were promoted if successful. Of course, there were risks of debt, corruption and self-interest which led to periodic crack downs. Also, regions could become protectionist to defend their industries and markets.

Tight party control gave confidence to consider a range of policies. The party drew on the ideas of reformer in central/eastern Europe who tried to insert market elements into a planned economy. There were also visits from Milton Friedman who lectured on ‘Using the market for social development’. He had a long conversation with Zhao with whom he was impressed – though they differed on the ability to combine controls and the market. Zhao hired Chicago economists, and when China joined the World Bank in 1980, it gave technical advice and gathered data. One Bank official said it was a marriage made in heaven: the party and Bank were both professional bureaucracies. Above all, there was a conference in 1985 on board the *Bashan* as it cruised on the Yangtze River: the economists held a range of opinion from British Keynesians such as Alec Cairncross; Otmar Emminger of Bundesbank, Janos Kornai from Hungary; and James Tobin from US. China drew on an eclectic range of ideas but there was no doubt who was in charge: the party could select which to adopt.

The next generation went further than Deng. They adopted more market liberalisation when price controls were reduced in 1992-3: now that the market economy was larger, the change was less disruptive. They also turned to a closer engagement with globalisation and multilateral institutions, with full membership of the WTO. China needed to be competitive internationally which meant more domestic competition by introducing market reforms to raise efficiency. Devolution to the regions was allied to a national strategy of a high-growth economy. Jiang Zemin, Zhao’s successor as General Secretary, commented in 1999 that “Competition based on overall national strength will increasingly become the leading factor deciding a country’s future and destiny... Only by constantly improving our economic strength, national defence strength, and national cohesiveness, can we remain invincible amidst increasingly intensive international competition, and truly safeguard our national sovereignty and national pride.”

Jiang looked to major Chinese firms that could compete internationally. There was a shift back to state-owned enterprises and collective TVEs, with state identifying sectors to grow. In 1994, four ‘pillar’ industries were identified. The aim was to pick winners with subsidies and loans, and to create Chinese companies with global brands – such as Huawei in telecommunications. In 2015, the policy of ‘Made in China 2025’ aimed to shift the economy from producing goods using cheap labour to capital intensive, technologically sophisticated goods with greater independence from foreign suppliers. And China has now become more assertive in its Belt and Road initiative, with heavy lending overseas.

The question now is: how sustainable is this situation?

- High savings have gone into property and local authorities have spent on projects which do not make a return. This property sector has been central to growth and now has serious problems.
- International tensions: China relied on export markets, not least in US which paid for by Chinese purchases of US debt. There is an unstable international relationship arising from internal inequalities in both countries – China over-saves and the US over-consumes.
- The US administration – both Trump and Biden – argue that China is not obeying the terms of membership of the WTO.
- China is more assertive – at the same time as Russia has become aggressively nationalist.

## Conclusion

The Cold War seemed to have ended in 1989 with the victory of democratic capitalism under a rules-based international order dominated by the United States. We now have a new stand-off between democratic and authoritarian economic systems.

- It is not like the Cold War: The Soviet Union was not deeply integrated into the global economy, and the US and Soviet economies were distinct. Now, the Chinese and American economies are deeply intertwined and attempts to uncouple them will be difficult.
- China is now the second largest world economy, and a major investor in the belt and road initiative; it is making claims to create a new set of international institutions through BRICS, the Asian Infrastructure Development Bank, and to make the renminbi a reserve currency. Could there be 'multilateralism with Chinese characteristics'? Internal tensions seem too great, and just as serious as in G7.
- Russia's economy is weak, but it has a nuclear arsenal and could form an alliance with China.
- And the United States has a serious problems of a failing political system.

Historians are not very good prophets – and Walt Rostow is perhaps a warning against allowing economic historians to guide policy. I hope I have told you how we got to where we are.

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