

## The Development of Market Economy in China

Tian Guang<sup>1</sup>, Liu Yu<sup>2</sup>, Lin Xiaoyan<sup>3</sup> and Kathy Tian<sup>4</sup>

### Abstract

The market economy contrasts sharply with the commodity economy that existed in China 2000 years ago. Its external forms and underlying meaning are mutually incompatible with traditional Chinese culture. In the world's recent history, market economy has strongly supported the development of the industrial countries and has created an amount of wealth within a short span of 200 years, which far exceeds the total wealth created by feudal societies over the course of thousands of years. By implementing a market economic system within the framework of socialism, China's strength is continuously increasing and the standard of living is constantly improving. Now, China has become the second largest economic entity in the world. However, the pan-marketization argument confounds right and wrong and advocates so-called economic theories that are unsuitable to China's basic conditions. Not only does it disrupt the rational development order of China's economy and society, but it also harms the basic interests of a majority of the people. The developmental history of market economy shows that pan-marketization is not suitable to China's society.

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### 1 History of Market Economy

The formation of market economy is based on large-scale production, marketization and modern commodity economy. In essence, it is a resource allocation method. It is not only a form of social and economic operation, but is also a form of social and economic

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<sup>1</sup>Professor at School of Business, Shantou University; a doctoral supervisor professor at School of Management, Hebei University; a professor and dean of Advanced College of Applied Anthropology, Jishou University.

<sup>2</sup>Corresponding author, currently an associate professor of Business Administration, School of Business, Shantou University.

<sup>3</sup>Graduate student at School of Business, Shantou University.

<sup>4</sup>Graduate student at London School of Economics.

development. Under the conditions of market economy, all factors of production enter into the market, with the market mechanism as the basic means of allocating resources. Commodity producers and operators of goods produce and circulate products in accordance with the objective laws of the market economy.

### **1.1 The Origins and Characteristics of Market Economic Theory**

In contemporary industrialized countries, the mainstream market economic theory is closely linked with capitalism and classical political economics. In the late 18th century, the United Kingdom was at the eve of the Industrial Revolution. That special historical environment produced classical political economics, which has had a profound impact on contemporary capitalism, with an Englishman, Adam Smith, as its representative. From the late 15th century to the 17th century, along with the world's great geographical discoveries, capitalist economic relations appeared and developed within the European feudal countries. As the production and development of capitalist economic relations demanded large monetary capital, the primitive accumulation of capital lasted for several centuries. Mercantilism was the school of economics that represented the business interests of the bourgeoisie in the primitive period of capital accumulation, and the "pre-history" of bourgeois political economy. It had a profound effect on the formation of classical political economics.

### **1.2 The Formation of Classical Economics**

Market economic theory was emerging in the United Kingdom. Adam Smith promulgated its main early concepts. The era of Adam Smith (1723-1790) was a time where handicrafts continued to occupy the main forms of production in the UK and the economy was in the classical liberal market economy stage. It was the second stage in the development of capitalism. The first stage was the era of primitive accumulation period of capitalism. It was the primary stage of capitalism and the heyday of mercantilism in economic theory. In 1767, Hager Reeve invented the improved textile machine in England. In 1771, Kerouac successfully invented textile machine, which first used horsepower and then used hydraulic power later. The emergence of the textile machine represented the transition from manual techniques to machine production in the United Kingdom and cued the development of the capitalist production mode. In 1778, James Watt invented the steam engine, which represented the beginning of the capitalist industrial machine era. Thus, capitalism began to develop rapidly from the British island to the rest of the European continent. The bourgeoisie gradually reached a dominant position in the UK.

Before Adam Smith, the prevailing British mercantilism was an economics genre that represented the commercial interests of the bourgeoisie in the period of primitive accumulation of capital. For example, an Englishman named Thomas Mun (1571-1641), the representative of late mercantilism, wrote two books, namely "On the Trade between England and the British East India Company" and "England's Treasure by Foreign Trade", and proposed that international trade was an important source of wealth in the United Kingdom, and summarized the Trade Balance Theory (Man, 1996). In addition, some academic thinking about the principles of market transactions, such as personal utilitarianism of Bentham, promoting the idea that personal behavior was motivated by self-interest and that self-love appeared in the UK. Deeply influenced by mercantilism

and personal utilitarianism, Adam Smith conducted research based on personal experience and advanced early market economic theory. Adam Smith stressed that the management of all economic activities and the coordination of social contradictions was directed by an “invisible hand”.

In “An Inquiry into the Nature and Causes of the Wealth of Nations”, Adam Smith had a classic formulation, which states that as every individual, therefore, endeavors as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value. Every individual necessarily labors to render the annual revenue of the society as great as he can. He generally neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security. Furthermore, by directing that industry in such a manner that its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an “invisible hand” to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own self-interest, he frequently promotes the interests of society more effectively than when he explicitly intends to promote them (Richard, 2005).

The market economic thinking of Adam Smith is best described as a laissez-faire market economy universal theory. He advocated free competition that was against any form of state intervention. He lamented that if the the government owned the management of the land; the society would not get even a quarter of the existing production. The reason is that “the government agency and agent management was negligent, wasteful and arbitrary” (Smith, 1983). In the 1930s, a British economist named Eric Roll, published his well cited book “History of Economic Thoughts” and gave a comment about Adam and the essence of Smith’s liberal economic theory. He indicated that: when Adam Smith applied the rules of the natural order in economic affairs, he became a strong opponent of the government that interfered in industrial or commercial matters in various forms. Each individual was trying his or her best to reap the maximum benefits.

Adam Smith strongly advocated the implementation of a laissez-faire policy. Did he really expect to maximize economic and social interests? After a profound analysis, Eric Roll pointed out that Smith regarded the national non-intervention nature laws as the basis of economic policy; he was to provide a theoretical basis for the main interests of the entrepreneurial class. Roll addressed that in western society, it was always said that Adam Smith was on behalf of the interests of a single class. It was doubtlessly correct from either historical significance or subjective terms.(Eric Roll, 1981) Adam Smith advocated the free economy and the anti-national management, which was very much in line with the needs of the emerging bourgeois. In Western economics textbooks, he is named as the “Father of Economics”.

In fact, the laissez-faire theory Adam Smith advocated is not universally applicable. When establishing a scientific theory of communism, Marx had conducted an in-depth study on Adam Smith’s theory. He pointed out that Smith was exploring the internal relations of the various sectors of the economy, or the hidden structure in the bourgeois economic system; on the other hand, the contacts in competition and in the eyes of non-scientific observers who are actually involved in the production process of the bourgeoisie” (Marx and Engels, 1973). For Marx, Adam Smith saw only the appearance of things, not the true meaning. The reality is, when everyone is seeking the best interests, they will tend to damage the interests of others. Not only can the community as a whole not achieve maximum benefit, but also the society is likely to fall into chaos.

The era that Adam Smith said that the “invisible hand” guided all economic activities, was the era during which the western capitalist primitive accumulation period had long been over and the past years actually presented rather difficult times for most people and a paradise for few members of the elite. Looking back at the events that happened in history, such as the brutal British Enclosure Movement, black slave plantation system, California Gold Rush and the blood and sweat labor system in 18th and 19th century, the “invisible hand” sounds appealing. However, this wantonly waving hand also produced endless human tragedy. History is a mirror that illuminates the true colors of the laissez-faire market economy movement. Modern China must not allow the kind of beautiful Pan-market-oriented economic theory run amok.

From the views of the balance between individual and collective interests, as long as everyone contributes a little love, the world will become a better one. Yet, if everyone becomes selfish, the society will certainly be disharmonious. In the ancient Chinese sage Confucius perspective, the highest purpose of political thought is that people share the world. Society should select people of high moral character. All people have to emphasize integrity and cultivate a harmonious atmosphere. So people not only take care of their own parents and bring up their children, but also try hard to feed the elderly until the end of their natural life span. Middle-aged people should contribute to society. Young children can successfully grow up. Finally, the old man without wife, old woman without husband, and the child who lost his father when young, the old people without sub, and the disable people can get support. The men have occupations, and woman can get married timely. As a result, there would not be any thief, rebellion and evil will not happen, and every household need not close the gate. This is the ideal society (Quoted from *The Books of Rites*, Li Yun 9<sup>th</sup>).

People all over the world are in the pursuit of “common ground”, and the realization of the ideal world should not rely on selfish behaviors, but the ideological guidance of “the whole world as one community”. Only then can society achieve harmonious development status. As such, the people become very selfish, only care about themselves and ignore the interest of other people...then wars happen (Quoted from *The Books of Rites*, Li Yun 9<sup>th</sup>). People only caring about themselves and their relatives will result in wars and tragedies. In fact, a person should take the needs of others into account, and then he can achieve personal interests without infringing upon the interests of others. Another Chinese ancient sage the Mencius suggested, we should care about our own parents as well as the parents of other people. At the same time, we should not only take care of our own children but also the children of others. If we can make it happen then we can control the world easily (Quoted from Mencius, Lianghui King).

Only the person who loves the others as his or her family can get the endorsement and support of others. According to Adam Smith, however, as long as the “invisible hand” plays a full role in suppressing the intervention of the state, the individual and society can get the maximum benefit at the same time. It does not work in reality. If each person becomes selfish and unscrupulous, it will ultimately damage his own interests. If the interests of society as a whole are destroyed, how to achieve the purpose of individuals that gain the greatest benefits at the least cost?

The analysis of Adam Smith on the constitution of the value of the goods is correct. He said, labor was the yardstick to measure the value of all commodities exchange (Adam Smith, 1983). He regarded labor as the only source of value; the amount of labor contained in a commodity was the yardstick to measure this value. This labor theory of value is undoubtedly correct. Marx made a thorough research on Adam Smith's doctrine

and gave a fair evaluation about his historical position: Adam Smith developed political economy into some kind of overall. The scope he included had been formed to some extent (Marx and Engels, 1973). Marx's political economy critically inherited and evolved based on classical political economy.

As China never experienced market economy but some different forms of commodity economy, so Adam Smith's theory including the mistaken views was consciously or unconsciously accepted in the country's reform and opening-up process. It should be noted that the market economy is different from the commodity economy that existed in China 2000 years ago. Commodity economy is the primary form, in which only commodities entered the market for commodity exchange. Market economy is a product of production socialization: (1) all the factors of production such as capital, labor, land, information, and technology and so on enter the market; (2) it forms a nationally and globally unified and not divided market. Only in this way, the price signal is not blocked, and the price reflects the scarcity of resources; (3) market becomes the center of the resources allocation, so that the law of value, supply and demand law, and competition law helps to allocate resources and productivity, coordinate the relationship between supply and demand. As the market economy is complex, people are looking for personal interests. No government can step in to regulate the market. China's reform has proved that the rational allocation of various complex production factors, especially the national strategic resource reserves and production, must be under government's unified intervention and deployment.

### 1.3 The Differentiation of Classical Economics

Since the end of the 18th century and the early 19th century, the industrial system of the capitalist machine was established. At the same time, contradictions of social class were becoming increasingly acute. The classical economics founded by Adam Smith began to differentiate. One thought was the income constitution axiology which gradually developed into political economy defending for capitalist economy, and its representative was Jean Baptiste Say (1767-1832). Say lived in the era of the French bourgeoisie trying to seize power. The French utopian socialism criticized the shortcomings and contradictions of the bourgeoisie, and encouraged the struggle of the working class. The contradiction between the proletariat and the bourgeoisie became sharper. At the same time, some French economists and political activists such as Garnier were writing books to express their points of view. Say published "Introduction to Political Economy" in 1803, which was his masterpiece that advocated liberal economic views. Marx said tartly: after Garnier, Say Jean Baptiste published his vulgar book *Introduction to Political Economy* (Marx and Engels, 1972).

Say expanded some erroneous ideas of Smith and set up political economy for the defense of the capitalist economy. Marx sharply criticized Say, claiming that Say was the vulgarization of Smith's theory (Marx and Engels, 1972). Say established economic views, which fully advocated laissez-faire based on theory of supply and demand, and production costs, against the state interfered product price and other economic activities in any ways. A central feature of Say's theory was that the effectiveness was the determinants of value. In his view, the value of all the production elements came from the value of their products. All elements have the necessary characteristics to create value of scarcity and indirect utility.

Say put forward a so-called theory of distribution from an argument that utility

determined the value, and strived to promote the view “supply creates demand”. He advocated that, under conditions of economic freedom, the phenomenon of insufficient supply of one product and excess supply of another at the same time would not exist forever (Say, 1983). Because of the self-regulation of the law of value, production was always conducted in accordance with the needs of the community. General overproduction would never happen. The internal contradictions of capitalism made the value of the commodity to become the abyss capitalists faced and Say attempted to solve this dilemma encountered by capitalist production. Therefore, this argument was regarded as “Say Theorem” in the economic circles of the capitalist and became a sacred dogma of modern western economics. Say’s ideas later became one of the foundations of bourgeois vulgar political economy theory. The British economist mentioned above, Eric Roll viewed the Say Theorem and its disciples that they gradually abandoned the labor theory of value, and applied another different principle of interpretation: this principle excluded the remaining concepts. In technical terms, this meant that the development of a utility value theory would inevitably result in recognizing capital was productive (Eric Roll, 1981).

What is the core idea of Say’s theory? Marx criticized Say’s vulgar economic concepts from a deep level, especially the theory of distribution. Say opposed the government’s intervention in production and was opposed to the products flow compelled by government (Say, 1983). Say’s theory tried to prove that the market economy has inherent stability: governmental intervention in the economy should be abandoned. If Adam Smith’s theory of free economic was to crusade against that feudalism impeded free economic competition, it reflected the historical trend of the development of the commodity economy in a period of rising capitalism. It has the role of promoting the progress of the development of the capitalist economy. The “Say theorem” directly denied the contradictions of capitalist production and consumption and thought that supply would automatically create a demand; there was no possibility of widespread overproduction crisis, and the capitalist economy could be in balance perpetually.

#### **1.4 The Theory of the Market Economy is gradually Changing**

Adam Smith’s free competition and laissez-faire theory was popular in the United Kingdom, the United States and other capitalist countries in the 18th and 19th centuries. It was because the enterprises existing in such capitalist countries generally were small scale. It was difficult for an individual private enterprise to hold a monopoly in the market, so the set of theories was feasible under that historical circumstance. Due to the widespread implementation of the Adam Smith’s free-market economic theory, Western countries’ social productivity was higher than ever before, achieving rapid development of science and technology, and a sharp increase in material wealth. However, by the mid-19th century, the development of capitalism had created many large enterprises whose monopoly had become increasingly evident. The problem of the market economy also became prominent. The characteristic of the market economy was that resources and wealth kept flowing from low efficiency to high efficiency.

Therefore, it caused serious bankruptcy, unemployment, and polarization. Private ownership of capitalist with small business owners as the main society had large conglomerates, which is different from Adam Smith’s new capitalist society. Capitalist exploitation was more brutal than ever before. Labor workers became the talking machine. This also meant that Adam Smith’s theory of free competition failed. Because of

the seriously unfair society, early western capitalist society was facing surging workers movement. The confrontation between employers and employees became fiercer and fiercer and the society tended to be turbulent. In this background, Marx put forward the theory of the socialist economic system and socialist revolution, aiming to promote a planned economy, which advocates equal interests in the community as a whole.

What is the basis for doing as such? Adam Smith demonstrated that the market economy was not a panacea, and had some limitations like any other economic systems, such as: (1) competition in the market could not always be perfect competition; imperfect competition had a greater proportion of economic activities. (2) The phenomenon of increasing returns to scale may lead to monopoly. (3) There were incomplete externalities and public goods in economic activities. (4) The allocation in the market economy could not be fair. (5) Due to the presence of irrational individual economic behavior, transaction risk caused fluctuations in the economy. About the historical role of capitalist market economic system, the founder of the theory of communism, Marx made an objective evaluation; bourgeois society is the most complex and the most developed production organization in the history. At the same time, he also issued a warning to the limitations of this economic system, "If the argument that bourgeois economic category contains a form which was suitable to all the other social forms was right. Then, this could only be understood in a certain sense. The final form of historical development was always built on the development of past historical forms. As historical development only self-criticize under specific conditions, it always one-sided understands the past forms" (Marx and Engels, 1962).

The development of history is a continuous process, so is the development of an economic system. It was no longer the private enterprises style economic structure in the 1870s (Hobsbawm, 1999). Now, United States still pursues Keynesianism, which advocates massive government intervention in the economy. It is very different from the market liberal economy of Adam Smith. Some people developed the government intervention theory of the Keynesian theory and formed the Post-Keynesian school. The reason is that the capitalism in the 19th century was classical naive capitalism and primitive accumulation stage, in the form of "free market capitalism." In the 20<sup>th</sup> century, especially in the second half of 20<sup>th</sup> century, the capitalist economy had fundamental changes. Government interfered more and more in the economic affairs.

### **1.5 The Success of the Socialist Market Economy**

In the first half of the 20th century, some politicians and scholars in western capitalist countries reflected on the reasons for recession and learned from the successful experience of the emerging socialist countries in the post-World War II. The brilliant success of building socialism of the former Soviet Union, Eastern European countries and China, the early planned economy and the great power of the social security system, as well as the resolute struggle of the working class and the revolutionary party in capitalist countries shocked upper representatives of the capitalist countries. In the process of trying to come up with countermeasures, the upper representatives in capitalist countries were forced to learn a lot of excellent management experience of socialism in the Cold War within the socialist camp. Under the control of executive power and the premise of the capitalist exploitation system, Britain and other countries have carried out many social and political self-improvements, aiming to demoralize and conditionally ease the domestic revolt of the working class. The major capitalist countries got rid of the dying

plight after getting the excess profits from information technology. The country's economy slowly recovered. Errors within the socialist camp also provided an opportunity for capitalism to flourish.

In the 1930s and 1970s, market economy countries faced two global economic crises and suffered great losses. As a result, the market economy countries became painfully aware that the market mechanism had its natural defects and that the government must use macro-economic control to operate the market. After the 1980s, the morphology of the market economy transitioned from a free market economy to a modern market economy on a global scale. This is known as the control of "invisible hand" and "visible hand". The "invisible hand" controlled the micro field and played the role of stimulant. In contrast, the "visible hand" controlled macro-areas and played the role of coordinator. According to the trend of the global economic system reform, the capitalist countries with the United States as their representative, are trying to strengthen the governmental function, seeking effective interventions of government in economic operation. Although there are some "conservative" representatives in western countries that are stubborn and dogmatically insisting on the ideas of Smith, their intention is not purely for economic interests. They believe that the executive intervention is detrimental to social democracy and freedom. In short, the historical changes in the economic system show that the market economy has two sides. It is not only an "invisible hand" which promotes the development of human beings, but also an invisible "feet" which impedes the pursuit of personal interests.

The socialist countries, with China as their representative, have developed socialist market economy with Chinese characteristics by introducing market economy theories and implementing reforms. Over a period, China made great efforts to shift from a planned economy to a new policy. The Chinese government should timely develop and implement the most appropriate and comprehensive strategies according to the actual situation in China, the development of the implementation of the benefits of the best strategies and policies. In the process of establishing a socialist system, China has explored some unique economic theories and economic policies, and the practice has proven that these theories and policies are effective and consistent with Chinese people's interests.

## **1.6 "Neo-liberal" Penetration in China**

In "Das Kapital", Marx pointed out that the most fundamental contradiction of capitalist system was the contradiction between socialized production and private ownership of the products. The intensification of this contradiction would cause economic crisis and production stagnation, which lead to social chaos and worldwide turmoil and wars. The internal mechanism of the capitalist system only creates and exacerbates the conflict, so this system will inevitably die and be replaced by the new socialist system. History has proved Marx's brilliant thesis.

## **1.7 Neo-liberalism**

During 1974 and 1975, the contradiction between large-scale socialized production and private ownership was re-intensified in the capitalist countries, which led to a cyclical new world economic crisis, namely the new economic crisis in the form of the stagflation phenomenon in Western industrialized countries. Keynesian interventionist policies failed to rescue the economy, so the politicians and tycoons of the capitalist countries were eager



to seek a solution to solve the dilemma. In 1978, the American economists Rose and Milton published “Free to Choose”, criticizing the Keynesian interventionist economic policy, and attempted to find a solution which not only maintained the capitalist system, but also eliminated the new cyclical economic crisis. Then, many other scholars tried to find out solution from a new perspective, such as Milton Friedman’s monetarist policies and Robert Lucas’s “rational expectation” theory and supply-side theory. This trend of thought is termed as “neo-liberal” ideas in the West. Since their representatives and believers gathered in the University of Chicago, it also known as the “Chicago School” (He, 2004). These people advocated and interpreted the free economy of Smith and Say, and opposed Keynesianism. Therefore, they were also known as the “Post Keynesian revolution”. After a period, neo-liberalism spread around the world and penetrated in China, attempting to influence the reform and opening policy of China.

### **1.7.1 The neo-liberal “beautiful new world”**

Neoliberal writings discussed money supply and monetary policy and utilized mathematical formulas such as “monetary equation” and the “Cambridge equation” to analyze the changes in the economy. The book “Free to Choose” published in 1979 was written by the former president of the American Economic Association, Milton Friedman. Friedman was also an economics professor at the University of Chicago, who extolled free economic operation and Smith’s “invisible hand”. In this way, voluntary actions of millions people can be coordinated through the price system, without the guidance center. To Friedman, voluntary transaction dominates the economy; the inside has the potential to promote prosperity and human freedom. It may not take full advantage of its potential in these two areas, but as far as we know, the main organization form of prosperous and free society must be voluntary trade... free trade is a necessary condition for prosperity and freedom (Friedman, 1982).

Friedman is a leader of the neo-liberal monetarist. In his view, the fundamental flaw of the socialist system is the national plan, which was contrary to the “voluntary transaction” law. He strongly advocated liberal economic and opposed to the socialist system. He won the Nobel Prize in economics. An economist professor named Xijun Gao who was from Taiwan, China, wrote a book called “The World of Economics”, aiming to make Friedman’s monetary theory easier to understand. Xijun, Gao describes the Paradise Model of neo-liberalist in this way: The government control is reduced to a minimum, people’s incentive reaches the highest; consumers have enough information to make an informed choice. The manufacturers should be allowed to expand when in benefit, and allowed to bankrupt when in losses. There is no deficit in governmental budget; the money supply should be stably controlled. Give cash when poor people apply for relief; give tax cuts when the rich create wealth. Personnel capital goods can flow freely in domestic without national intervention and limitation of other countries. In a fair competition, efficiency is more important than the fairness, freedom is more important than equality.

This “Beautiful New World” is wonderful and extremely harmonious, and the road to this world is the free market economy. About how to enter it, Gao further commented that Adam Smith used the concept of “invisible hand” to point out that everyone directed the operation of the economic activity in the pursuit of self-interest. It resulted in consequences of “self-interest” and “win-win” - price mechanism. Nevertheless, this ‘invisible hand’ was not as wonderful as described. Facing the Great Depression in 1930,

the political sector – the “visible hand” - had no choice but to interfere. On the one hand, it brought a change in the capitalism nature of the Western world; on the other hand, it made Keynesian theory popular for five decades (Gao, 1987)

### **1.7.2 The results of implementing “neo-liberalism”**

In the 1980s, the neo-liberal economic thoughts were quite active in the Western world, and had a major impact on the governmental decision-making in United States and European countries. Ronald Reagan and Margaret Thatcher even applied neo-liberal thoughts in economic policies and actual economic and social affairs. Such policies focused on two points: first, to minimize government function and advocate libertarianism; second, the economic system tended to be privatization and liberalization. However, the results of the implementing neo-liberal economic policies did not reach rulers' expectation and did not produce the paradise described by Professor Friedman. For example, in order to get rid of the “stagflation” of the economy, Margaret Thatcher government of United Kingdom launched a privatization campaign, attempting to stimulate British economy. However, during the implementation of this policy, the number of unemployed in Britain suddenly increased. Workers set off a strike to protest against the capitalists' brutal exploitation of workers. In 1979, British Steel workers went on strike. During 1983 and 1984, coal miners set off a large wave of strikes. The social contradictions in Britain were suddenly intensified. The ruling class fell in a panic, and blamed each other. The strikes of coal miners led to a 1% decrease in gross national product of the United Kingdom and £4 billion loss in the international balance of payment. The British government was forced to suspend the privatization process.

### **1.8 The Substance of New System School**

There is a genre of neo-liberalism called “new institutionalism” represented by North and Ronald Harry Coase. North systematically put forward the theory of institutional Change in the books “Structure and Change in Economic History” and “System Innovation and United States Economic Growth”. On the premise of “economic man” assumptions, North believed that all people were selfish and pursuing personal utilitarianism and free competition. It was not only the basis of the system, but also the motivation of institutional transition. North stresses that Institutional equilibrium was such a state that when the bargaining power of the actors and the contract negotiations of overall economic exchange were given, no actor can get profit from using resources in re-establishment of the contract (North, 1994). This argument was carried out in the situation of Pareto marginal optimal equilibrium, which did not exist in reality.

The “Institutional Change Theory” proposed by North has a clear purpose. He believed that the main clue of economic history is the history of institutional change. It is not only the process of institutional change, but also the process of political behavior. North attribute the economic growth of the Western world to the incentive mechanism provided by the capitalist system. In his view, the reason for the rise of the Western world is the development of an effective economic organization. Effective economic organizations need to build institutional facilities and determine the ownership of property, to continuously lead the individual economic efforts to become social activities (North, 1988). He also specifically disclaimed that if a social ownership system clearly defined the exclusive right of everyone, then the community would be more innovative. This

process was a systematic innovation process. As the school of New System Economics speaks highly of capitalist system, it gained an acclaim from the capitalist world.

The other important thought of New System School is the “Property Rights Theory”. In 1937, Ronald Harry Coase published an economic paper named “The Nature of the Firm”, and first proposed the concept of “transaction costs”, establishing the initial theory of Property Rights System Change. Coase described the effectiveness of property rights that was embodied in the capitalist system. It enabled people to automatically know what to do and how to get benefit in the transaction process, and ultimately achieve maximum benefits. In 1960, Coase published another paper “The Problem of Social Cost”, and in 1988 published “Notes on The Problem of Social Cost”. He systematically discussed the relationship between property rights, transaction costs and resource allocation, his followers termed his theory as “the Coase Theorem”.

Objectively speaking, the “Property Rights Theory” made up for the theoretical errors made by the capitalist political economist error and played a role of stabilizing capitalist economic system. Coase clearly expresses his aim of studying property rights arrangement is to create a theory which can help us analyze the determinants of the production’s institutional structure (Coase, 1990). Coase’s statement about the changes in property rights system attempted to demonstrate that privatization can stimulate economic development. The theory of New System School has certain significance for China’s economic reform. However, some Chinese academics regard it as a treasure and deny its class nature and effectiveness, attempting to change the structure of property rights in China. This approach is absurd, and the consequences are particularly injurious.

### **1.8.1 The “Shock Therapy” of the New System School**

The most powerful historical evidence of New System School’s political tendency is that, during 1980s and 1990s, arguments about the change of ownership were spread to the former socialist countries in Eastern Europe to provide a theoretical basis for the privatization movement there. For example, some United States scholars who had very obvious ideological tendency continued spreading liberal economic ideology to the former Soviet Union and designed the so-called reform plan to improve economic efficiency, such as “Sachs Shock Therapy” and “Harvard 500 Days Program” to induce them to carry out the reform of property rights. However, the total privatization economic reform applied by the Gorbachev - Yeltsin government resulted in very serious consequence. The economy of Russia collapsed; the society fell into chaos and people’s living standard declined sharply. The property rights revolution in the former socialist countries in Eastern Europe also resulted in a decline in production, a depressed market, and economic and social chaos.

After nearly 20 years of sweeping privatization reform, the original state-owned enterprises in the former Soviet Union and most Eastern Europe districts were completely destroyed. The national economy lost competitiveness in the world market and the domestic market. But Ronald Harry Coase was greatly praised by the Western countries. In 1991, Coase won the Nobel Prize for Economics. North won the Nobel Prize for Economics in 1993. After the reform of property rights and economic privatization, Eastern Europe and Russia have become a new market for Western transnational monopolies to find new living space. Russia’s strong economy and industry has generally collapsed, which provides a realistic possibility for the United States to implement the national missile defense system (NMD) and attempt to dominate the world directly. This

is the outcomes and goals of neo-liberal economy, China will never allow them to succeed.

### **1.8.2 Disguised Ideological Tool**

The historical facts show that the neo-liberalism's academic atmosphere is only in appearance; it is essentially an ideological tool. Its most praiseworthy achievement in the Western world is to destroy the economies of the former socialist countries. This paper has introduced Say's theory that "supply automatically creates demand" and the government should not interfere in the economy. Some Western economists named Say as the godfather of the "liberal economics". However, some other Western scholars refuted his theory. The German economist Friedrich List (1789-1846) had systematically criticized the "liberalism" and exposed the true face of the Say's theory. He indicated that Say did not have extensive knowledge of national policies and profound observation ability, did not have political and philosophical vision, either. Based on the insights taking from others, Say tried to find examples and facts that can support his views from history, politics, and statistics as well as industrial and commercial relations (List, 1961). List was not in favor of the socialist ideology that had been popular in Europe, but he was against Say's liberalism pseudo-science. His critique is undoubtedly correct.

Although the Keynesian school of economics saved the capitalist economy for a short period, due to the insurmountable contradictions within capitalism, the western capitalist economies had a serious "stagflation" situation again in the 1970s. Therefore, in addition to the monetarist school, another representative genre of the United States "Post Keynesian revolution", the "supply-siders" appeared. This school thought that the error of Keynes was to deny the validity of "Say's Law", and blindly implement expansionary fiscal and monetary policies to interfere in the economy that resulted in "stagflation". A representative of this school, George Gilder argues that the various changes of Say's Law are the basic rules of supply-siders. Say's Law is important because it focuses on the supply and the ability to stimulate capital investment (Gilder, 1985). He appealed to abandon Keynesianism and to go back to the liberal economic route advocated by classical economics. Marx pointed out that vulgar economics just uses bourgeois agent's view to explain, systematize and defense. (Marx, 1966). The purpose of Neo-liberal economics is to cover up the fundamental contradiction of the capitalist economy.

## **1.9 Features of Western Contemporary Economic Entities**

From the 1870s to the 1930s, the production technology of the capitalist world has improved tremendously. The industrial production grew rapidly and the scales of enterprises become larger and larger. A large number of joint-stock companies and monopoly organizations appeared because of the increasing concentration of capital and production. Capitalism transited from free competition stage to monopoly capitalism. The founder of the world's first socialist state, Lenin, in his famous book "Imperialism is the highest stage of capitalism", profoundly analyzed the subjectivity changes of capitalism. Lenin seized the opportunity to launch a war against imperialists, and established a new socialist country in the history of humankind. He turned Marxist theory into reality.

The strengthening capitalist monopolies and the intensified economic crisis resulted in the profound changes of capitalist economic entities and the school of economics. Especially in the 1930s, the economic crisis of the capitalist world has led to a profound social crisis,

which forced Western economic powers to take some regulation policies of the new social system and gradually form a mixed economic system. Take the changes in the United States since 1930 as an example- the U.S. economy gradually changed to become a capitalist-oriented mixed economy. Both individual and government had economic influence in the market. The characteristic of most industrial sectors of United States was that a relatively small number of large-sized enterprises rather than a large number of small-sized competitive enterprises dominating the entire sector.

Pre-existing private ownership of the free-market capitalism changed. This form of market termed by Vladimir Lenin as “oligopoly”. At present, monopoly companies in the western countries have become large multinational companies. These super companies are dominating the economic lifeline of the world. The operation of Multinational Corporation is not purely economic. Administrative intervention has a strong impact on the company. In Germany, the famous Volkswagen AG and Lufthansa Airlines are multinational companies with national shares. Even in Britain, state-owned enterprises still occupy an important position in the national economy.

### **1.10 How Neo-liberal Economics Thoughts Penetrate China**

When China is implementing reform, the developed Western countries seek to obtain high profits from global economic integration. Some multinational companies with political backgrounds invest in China, aiming to occupy the Chinese market instead of helping the China's social construction. Out of the global strategic considerations, some Western powers are trying to carry out value penetration by introducing neo-liberal economic views in China. This is not surprising. In the entire history of the 20th century, the Western economic powers use a variety of ways to promote and implement a capitalist system. For example, the United States has been selling its own values to the world. However, those ideologies are not suitable to China.

Through a number of channels, the neo-liberalism prevailing in the United States, Britain and other countries reached into China. Some advocates of the neo-liberal thoughts praise the change of ownership in an exaggerated manner. For example, a neo-liberal economics professor arbitrarily said, “the economy of every country with rapid growth is built on the base of private enterprise system. It means that most of the productive resources are owned by the private person and free from government intervention”. He even advocated anarchism: “I think there is no corruption if there is no government control and regulation”. He also arbitrarily judged, the total elimination of government is equal to the total elimination of corruption” (Zhang, 2000). This so-called theory is totally inconsistent with the reality of contemporary capitalism, and cannot find any meaningful proof in the history of capitalism.

Modernized mass production is a complex cyclic process. The efficient operation of every link needs a variety of supporting conditions to guarantee. Privatization cannot solve all the problems. The privatization of each process is unable to achieve the multinational large-scale joint operations. In the social development process, certain social superstructure is always adjusted with a certain social and economic infrastructure. The situation of economic base determines the nature of superstructure, in turn, the superstructure serve the economic basis. The modern mainstream economics is Anglo-American genre, which develop ideologies and theories based on the economic activities in the United States, Britain and other industrialized countries. A large number of theoretical explanations and case studies are studying how to make industrialized

countries more prosperous and more profitable. There is no theory studying the economic activities in developing countries until 1960s. This new theory named “development economics” observes and analyzes the market situation, investment opportunities, financial market and foreign exchange of developing countries from the perspective of outsider. Obviously, this theory is to provide advice for the industrialized countries to occupy the markets of developing countries.

### **1.10.1 Neoliberalism influences China’s reform**

Since mid-1990s, China’s economic reform concept has been significantly affected by “neo-liberalism” views, especially the so-called “property rights revolution” of new systematic. Some people in mainland China simplistically assert that the poor performance of state-owned enterprises is because of the unclear property rights. They think that if there is a change the property rights system of state-owned enterprises in China, it will be able to immediately improve the production efficiency of enterprises, which lag in technology. A few people are trying to develop an unrealistic “joint-stock reform” program, aiming to split the public property rights with private person. State-owned enterprise is actually decomposed and eroded. The property accumulated by some units for decades are turned into private property instantly. Improving the efficiency of production is a complex process. Property rights reform is just a part of the process. The key to improve social productivity is the science and technology innovation. Science and technology are primary productive forces. Changes in property rights cannot be a substitute for inventions.

The more serious problem is that property rights are the most central element in the economic entity. The changes in the property ownership have a great impact on the normal operation of the economic entity. The nature of the economic entity undergoes a qualitative change after a change in the nature of property rights. For example, in a period of time, under the instigation of the Pan-marketization thoughts, some people advocated to trade in the market for technology in mainland China. In order to import the technology of the Western countries, some state-owned enterprises gave up property rights and turn into a joint venture. Finally, these state-owned enterprises were merged by foreign enterprises. We can see that the contemporary capitalism is not the *laissez-faire* capitalism, which is built on these-called “clear property rights”, but capitalism which advocates foreign expansion, mergers, and monopoly.

After China’s state-owned enterprise turned into a wholly foreign-owned enterprise, the actual operation is not as per the expectations. As these state-owned enterprise lost market, it meant that they also lost technology and rights of ownership. Among all the radical reform practices influenced by pan-marketization thoughts, the measurement of “clear property rights “ is out of control, resulting in the fact that the reform of old system aiming to improve state-owned enterprise effectiveness do not reach the expectation. The contemporary socialist reform has to keep learning, so that the people recognize the true face of neo-liberalism. Only in this way, the economic construction can progress.

### **1.10.2 The loss of state assets**

A few economic powers always want to impose their own values to the Chinese people. Under the cover of neoliberalism, these countries admire *laissez-faire* economic policies and advocate that privatization of enterprise property rights is the only way to develop productive forces. It is easy for the people with philosophical knowledge to know that,

although the superstructure has a dynamic role on the economic base; there is no mutual relation between the superstructure and the economic base. Neo-liberalism is just a slogan and ideology and can never become an active and effective economic policy. The neo-liberalism theory of Economics Anglo-American genre was born in the Western industrialized countries.

It is the abstract principles of economic and social activities in United States and Britain. Most of the teachers and advocators live in the industrialized countries, or receive education in those countries. As a result, these theories aim to maintain economic interests of those countries. People who think independently will see through neo-liberal's intention is to replace socialism "opening up thought" with capitalism liberalization and attempt to bring socialist economy into the orbit of the capitalist economy. Some people in China are interested in analyzing China's social and economic life by capitalism theologies. It does not conform to China's national conditions.

Table 1: Registered Unemployed and Unemployment Rate of China Urban  
Unit: million people ; %

Year \ Item	1990	2000	2007	2008	2009
Urban registered unemployed people	3.83	5.95	8.3	8.86	9.21
Urban unemployment rate	2.5	3.1	4. 0	4.2	4. 3

Source from: National Bureau of Statistics. China Statistical Yearbook 2010 [Z]. Beijing: China Statistics Press, 2010.

China has the largest population in the world. Most of the rural population does not have any social security. In the past, state-owned enterprises provided medical aid, pension and other support systems to maintain the urban security and stability. However, after the radical restructure of state-owned enterprises, many enterprises went bankrupt and a large number of worker were laid off simultaneously (see Table 1). Although the restructuring of state-owned enterprises, the continuous increase in the number of unemployed people did not cause the increase in unemployment are related to the restructuring.

At the same time, a large number of new labor force entered the job market, labor and social security and employment immediately become very prominent issues. There is a lot of pressure in economic, social and political fields. We have to recognize the fact that certain social economic bases will produce corresponding culture and ideology. This consciousness not only has the potential to surpass the base, but can also imprint the base. When introducing Western market economic theory, we must distinguish the theories of general objective laws of market economy and the capitalist ideology. We must try our best to prohibit the capitalist ideology impeding the development of China's market.

### 1.11 Aware of Different Bias

Neo-liberalism became popular in the contemporary international community, especially after the disintegration of the former Soviet Union. However, history is always full of twists and turns. An American scholar thinks that the collapse of the Berlin Wall and the Soviet Union does not mean the victory of liberalism. On the contrary, liberalism began to fall into decay. After 1989, the world has entered the era of "post-liberalism". Various

political trends and social phenomena in globalization continue to change, and the pattern of Cold War history will not be re-staged again (Wallerstein, 2002). Fortunately, in the tortuous and complicated process of reform, the top leadership grasped the general direction of reform and kept a clear head of the liberal economic theory. All the utopian “system innovation” was suppressed, and the so-called deepening reform with privatization as the ultimate goal was abandoned.

In order to develop the socialist market economy with Chinese characteristics, the government and people should explore the law of the scientific socialist market economy from the actual situation in China. We should clearly understand the “left” or “right” erroneous ideas and abandon the blind anti-foreign narrow sense of the past. Naturally, in the current case, the speech and behavior of pan-marketization economy should be abandoned right away. Otherwise, it is easy to get lost.

### **1.11.1 Abandon the pan-marketization economy**

Some people blindly follow the free market economy. They seem to totally ignore the economic activities’ new trend, commodity production and its new characteristics in contemporary capitalist society. They actually follow the puerile liberal economic theory that favors privatization as suggested by Smith and Say. These people, who blindly advocate dissolution of the large state-owned enterprises, think small is good, and China should return to the puerile capitalism with small enterprises and private ownership as the main body. China’s economic construction practice has proved yet again that the planned economy is not worthless. The planned economy and market economy can exist in together in the market in a harmonious way. The key to the development of socialism market economy with Chinese characteristics is to combine the advantages of both market economy and planned economy. We should neither boast about the role of the market, nor overly emphasize the planned functionality.

### **1.11.2 Adjust the position of the national management**

The construction of the socialist economy must abandon the rigid contents of the old traditions and keep scientific and reasonable core factors. At the same time, under the guidance of the right theory, the government should implement economic macro-control on the major projects related to the national economy and the people’s livelihood in order to unite the goal of economy and society. The national management should combine with the market regulation. We must recognize the dual character of the free economic theory. In short, government and market should have their own managing scopes and cannot be mixed. This is exactly the standpoint of the scientific development perspective.

## **2 Scientifically Utilize the Strengths of Market Economy**

Historical facts show that the market economy does not exist in isolation, but appears and develops in a certain social system and in some historical conditions. Therefore, we need to have a scientific concept of development: to follow the the objective laws of market economy, to seek the best resource allocation and to optimize economic and social benefits.



## **2.1 Correctly Guide the Operation of Market Economy**

How to correctly understand the market economy? What are its essential characteristics? The simple research results above show that the first research step of market economy is to analyze its existing economic system. Simply speaking, the market economy is a kind of basic approach to disperse policy decisions based on bartering. Commodity market, as a part of the market economy, is both abstract and concrete. It is the specific performance and reaction of social economic activities since the beginning of commodity production. They would not exist without the human market. From another perspective, it is the assembly of all economic activities of human society taking the market as the goal and the starting point. In addition to the market-oriented economic activities, the humanity also has another ways and types of economic activities such as the peasants' productive labors for their own consumptions and labors of the environmental protection workers.

Therefore, from the point of view of human society, market economy can just be seen as a part of the human social economy, but not all of it. Admittedly, developing the market economy is an important aspect to promote the development of social economy. However, the market economy cannot replace the other parts of social economy. The development of human society needs the all-round advancement of all aspects. The thought of excessive emphasis on market economy economic but ignorance of other aspects of social economy - does not comply with the all-round development of human society.

### **2.1.1 Follow the rules of market economy**

Just like all other phenomena that have laws governing their existence, market economy also has its market operation rule, which does not shift with people's subjective will. What is the market rule? The so-called market rule, in fact, is the performance of people's economic activities in the market and the market reflection to the people's economic activities. It contains two basic points; one is the supply of the market performance and its reaction to market changes and the second is the demand of the market performance and its reaction to market changes. These two aspects of performance and reaction reflected through the intermediary of currency. Therefore, the market rule also can be seen as the reaction of the market supply and market demand. Simply put, the price will rise when demand exceeds supply and vice versa. These two kinds of reverse changes lead to an equilibrium in the relation of supply and demand.

In modern times, the most popular textbook in China is "Economics", written by Samuelson. The first chapter of this book expounds the famous market regulation principle, namely the "invisible hand theory". In the regulation of the invisible hand, economic structure and institution are adjusted automatically, resources are obtained in the most effective configuration, and there will never be excess capacity and insufficient supply in the long term. To this extent, capitalism thoroughly gets rid of the cyclical economic crisis. This view is the extension of the "Say's Law" that supply automatically creates demand. From the perspective of history, Adam Smith does not identify the inner relation of the market discipline when he finds and expresses the market rule for the first and earliest time, limited to the social and economic conditions at then. Therefore, he regards the market rule as an "invisible hand" beyond people's understanding and control category.

However, with the further development of the human society and the improvement of science and technology, people not only obtain new understanding on the market and its law, but also explore some means and methods to master it, such as market research and

forecasting, market supervision and control, pricing discipline and tax regulation. Commercial institutions and government can guide the market through these means and methods, and thus weaken the decisive role of the market rule on the social economy. The Russia's implementation of "Sachs shock therapy" and "Harvard 500 Days Program" takes the market economy as the only mode of operation. The result is even criticized by economic scholars in capitalist society. Actually, in the United States, economists and government all claims to implement wide range of administrative or social regulation. Antitrust laws, industrial and social regulations, and industrial policies are the main ways that government regulates economic structure, production and project engineering" (McConnell, Campbell R. and Brul, Stanley L., 2001). These regulations are meant to maintain the economic growth of the United States. They also become the important contents of economics textbook. The purpose of those plans is clear. However, blindly following behaviors only end up with failure.

### **2.1.2 Punish illegal and undisciplined behaviors**

All people in today's Chinese society know the market economy. In addition to the propaganda of news media, the commodity market around the land tells people that market economy is actually existent. Some people also treat market economy as a panacea that can settle China's social and economic disease. It is this incorrect understanding of market function that brings a series of problems.

On June 23, 2010, the 15th meeting of the Eleventh National People's Congress (NPC) held the second plenary session. In this meeting, Liu Jiayi, the chief auditor of the State Auditing Administration, presented that the number of cases on major illegal issues and economic crimes that the audit office submits to the state council or directly delivers to relevant departments is up to 104, involving 473 people (Lin, Miao, 2010). On December 26, 2011, the national industry and commerce administration conference held in Beijing disclosed that Chinese industry and commerce system handled 1.3895 economic illegal million cases of all kinds, valued at 26.868 billion yuan (Liu, Changzhong, 2011). We can see all the violators have a common motive that seeks personal gains, regardless of the situation they are in. These facts have proved that the thought that all things should be linked with benefit, money and market is wrong. This incorrect understanding cannot only easily make mistakes, but will lead to error propagation. The banking system is one of the most significant institutions. It is worthy of further investigation. The focus of the regulation should be placed on the following fields: subprime loans, real estate loan risks, asset disposal behaviors of asset management company, connected transactions of trust and investment company, credit to related interest in rural credit cooperatives and the authenticity of increase in capital and share, because the occurring rate in these areas of is highly frequent and extremely harmful.

At present, there are also some social programs for public good that have been shaped by the market. It seems to prove that commercialization is more in line with the world trend. The wealth gap is widening. Education and medical treatment are prone to the development of marketization. These situations are not normal in the area of people's basic living needs. Therefore, we need to understand the market economy correctly, to reflect from theory to practice. People cannot completely comply with the rule that development must accords to the market economy, cannot ignore all sorts of evil fruits brought by the pan marketization. It is not sensible to give too little care to the legitimacy of the accelerated commercialization. We should look at these problems from new

perspectives and cannot just let the public suffer and endure. A feasible method is to intervene in the excessive market pricing behaviors by effective policies.

## **2.2 Study the Model of World Market Economy**

Free economy as a form of expression by no means is the most magical modeling economic system. The modern western countries through the actual reality have realized that the “invisible hand” is not the omnipotent God. The operation and management methods of market economy must be according to the actual situation of the country. Free-market economists propose the absolute exclusion of government intervention. Industrialized countries actually have modified the proposal. In the western countries, different market economy systems arise and the management methods are not the same.

We might as well observe the market economy from the 17th century, the time of the embryonic stage of market economy. Different countries form different modes of market economy, because the extent and methods of intervention and the recognition to the nature of the market economy are diverse. They can be summarized as the following kinds:

First, the free market economic model of America. The market economy of the United States emerged from its special cultural and liberal tradition. The character of its operation is the highly dispersed economy. The American society opposes government intervention with economic activities in any form. However, previous governments in effect had been participating and regulating economic activities in different ways. The American free market economy is not entirely free.

Second, the welfare market economic model of the Nordic. The Nordic countries form an organic system consisting of economic system, economic organization and social policies. The system is based on private ownership and is formed in the practice of pursuing economic efficiency and social equality. It stresses the private enterprise as the major driving force of economic development, highly developed social welfare, mutual cooperative spirit, etc.

Third, the social market economic model of Germany. Social market economy is in essence a kind of capitalist market economy based on free competition. The guideline of this economy is that government makes proper adjustment and makes the social security as the basic safeguard. After World War II, various economic policies formulated by all previous governments of Germany are based on it. Social market economy adheres to two basic principles: first, the main content of economic activity is market regulation. Market, as the foundation and bond in the economic operation, always is in the leading position. Second, market activities can be interned and coordinated by the state to a certain degree. The state has a function of guidance and regulation to provide social security by providing social welfare policies of social security, justice and social progress.

Fourth, the nation-leading market economic model of Japan. After World War II, the emphasis of Japanese government’s intervention lies in the total supply, and the bidirectional constraints between the government and enterprises. The government decreases the damage to the market and helps the enterprises as far as possible. In addition, the country gradually forms a government-leading economic system model that private enterprises as the government guides the foundation.

Fifth, the France’s plan-guided market economic model. The planned adjustment implemented by France after World War II is a typical “mixed economy”. Its rapid recovery and development of economy is the result of organic combination of the plan and the market.

Finally, the diversified practical economic models created by developing countries. Developing countries and transition economies are based on their own national conditions and historical and cultural traditions. These countries combine with the experience of other countries' economic development and learn the lessons for the adjustment of their economic policies. The purpose is to try to follow a path of market economy development according to the nation's conditions.

It is clear that the patterns of the market economy are diversified. Since the end of the Second World War, individual countries, especially the Western capitalist countries, constantly adjusted their own economic policies to meet to the needs of the development of the so-called economic globalization. They do not perfectly mimic the U.S. market economic model. Any country's economic model simply imitated by others is unlikely to achieve success.

### **2.3 Absorb the Cultural Nutrients of Humanity**

Some European countries, especially Germany, sum up an appropriate regional and national economic development model by the socio-economic practices, namely the social market economy.

#### **2.3.1 Learn from the social market economy model of Germany**

After World War II, a number of socialist regimes arose in the eastern European countries. These countries' economies and cultures experienced a rapid development period, and had far-reaching influence. Combined with the push by the organizations of the Communist Party, the socialist ideology comes up to the surface in the veteran capitalist countries one wave after another. The Christian Democratic Union of the West Germany's conservative parties also proposes a guiding principle of Christian socialist. The union considers that the capitalist economic system does not meet the national and social interests of the German people, and advocates the establishment of a new economic system. This party won the election in 1949. It signs the establishment of the first cabinet of the Federal Germany, the Adenauer government. The federal government proposes the principle of "social market economy" and put it into effect. The national economy of the West Germany smoothly transmits into the "social market economy" from the "wartime system" through the implementation of a series of reasonable policies, such as the currency reform, which has laid a good foundation for the future economic development (Qiu Yuanlun, 1988).

From the early 1950s to the first half of the 1960s, the Federal Germany enjoyed a rapid economic growth of development just because the implementation of the social market economy. Many Western economists call the outstanding economic achievements in this period as an "economic miracle". The post-war federal government of the West Germany implements a whole set of measures that guarantee the people's minimum consumption and basic living standard. They are an important part of the social market economy. The main purpose is to increase the actual income and the real purchasing power by controlling money supply and financial expenses that alleviate the inflation rate. The real implementation of the social welfare system includes providing subsidies to unemployed workers, and providing pensions, medical insurance to the retired or incapable workers (Zhu Zhengqi and Lin Shuzhong, 1989).

The basis of the social market economy is a mixed ownership economy. On the one hand,

it exerts great emphasis on the market competition. On the other hand, it also advocates the national intervention with the economy, namely the national functions of macro-control. This regulation includes not only monetary policies and fiscal policies, but also the national plans and the government's policies, such as government relief to the unemployed. The high-speed development of the state ownership is one of the major features of the social market economy. Although this form of ownership is secondary compared with the dominant capitalism, it plays an important role in the national economy, especially in the cases that the nation or order goods or directly take over the low-profit enterprises and economic departments (the national defense industry for example), and the state-owned capitalist enterprises supply non-state-owned enterprises with cheap means of production. There exists huge conflicts between the China's social market economy and Europe's and Germany's, but China can still learn some meaningful experiences to avoid some of the errors.

### **2.3.2 Assess the assumptions of the market economy system**

Some people advocate that the liberal market economy is different from the social market economy. Free economy as a special kind of system, the internal mechanism is the market behavior of individuals, who pursues the personal maximum economic interests, reaches the optimal resources allocation under the guidance of the market price. However, the market price mechanism cannot play a role in isolation. In the process of the realization of the optimal resources allocation, it also needs some preconditions: First, each market economic actor has the rights of free choices in the precondition of no harm to the interests of others. Second, the individual self-interest can be coordinated with the mutually benefits of all parties.

In addition to the assumptions above, the development of modern economy and economics also require the optimal resource allocation in market economy conform to the following conditions: (1) Complete and symmetric economic information. Buyers and sellers in the market have completely sufficient information about the content and quality of transaction. (2) Perfectly competitive market. The market has numerous manufacturers so that each size is small. Any potential competitors can enter this market without any obstacles. Each manufacturer is the price recipient and has no ability to manipulate price. (3) Constant or decreasing returns to scale. The unit cost of the product is unchanged or decreasing along with the manufacturers production scale expanded. (4) No externality. The productive and consumptive behaviors of businesses or individuals in the economic activities have no extra impacts on the external environment. (5) No transaction costs. (6) Rational economic man. Economic actors can always maximize their own welfare. The free economy cannot run without these assumptions, which is hard to realize in the real world. Therefore, the free economy does not actually exist.

From the negative situations appearing at the process of China's economic reform, people have reasons to suspect this kind of people's motivation who indoctrinates the privatization theory into China. The security of the modern developed capitalist system is based on the social security system of welfare capitalism. Obviously, it is wrong to advocate the implementation of the pan-marketization economic system reform. The implementation of the reform of state-owned enterprises is excessively radical. It breaks the old labor insurance and welfare but does not establish a feasible social security system. The historical experience of China for thousands of years shows that the emergence of a large number of unemployed populations has always been a signal of

danger, and the root of the social chaos.

## 2.4 Avoid the Defects of Market Function

The market economy system has already existed in Western countries for hundreds of years, forming many mature management methods that improve social productive forces. However, this system still has some serious flaws, especially in the early stage of its development. On the condition that the macroeconomic regulatory is still not standardized, systemic or sound, the intense impact force of market operation can easily bring damaging effects on the original economic harmonious relationship. The western market economic theory attached to the development of market economy undoubtedly has many excellent ideas. China's reform also confirms that there are a lot to learn from the development experience of the Western industrialized countries. Nevertheless, we cannot accept the theory without reservations, especially when the western world is continuously innovating it.

Since the 1990s, the western economic theory, from a macro perspective, points out that the market and the market mechanism itself have some activity boundaries, such as political boundaries, allocation boundaries, social boundaries, ethical boundaries and ecological boundaries, that is, the market economic activities in these areas often fail. The construction of socialism does not work only depends on the market mechanism, also cannot obtain high benefits in some important areas, including the key industries adjustment of the national economy, public welfare investment projects, social security system, ecological and environmental protection. The market economy is not a panacea. Some drawbacks that happened in the current Chinese economy confirm this judgment. Capitalism is led by personal interests to apply and develop the market economy. It actually expands the inherent flaws of market function. Some western people suffered the pain brought by this institutional shortcoming. Although the capitalist system has not come to the door of hell, the call for reforming the system defect is growing louder and louder. Thus, with the rapid development of Internet and the rapid expansion of economic globalization, people from developed countries pay more attention to the pursuit of common interests, especially in the United States, France and Germany.

For example, both German kindergarten games and American MBA courses tell how to cultivate the concept of teamwork and cooperation. International business competition also pays attention to seek the cooperation with rivals, striving to achieve a "win-win" solution. There will be no development of the so-called modern company if no cooperative exchanges happen, because profits are generated from exchanges. The new staff training rules in many world-famous multinational corporations prohibit the boost of individualism and selfishness. The actual operations of multinational corporations all have teamwork items. This is in fact to advocate a win-win situation, namely reaching the goal of common interests. The French economist Michel Albert once said: "The Greater Europe has created a social market economy, and China has created a socialist market economy.

Naturally, there are many differences and similarities between the two. They can become one of the magic weapons in the 21st century if they are able to integrate together" (Michel Albert, 1999). We can see that the common interests meet the common requirements of the progress of human society, and make the common aspiration of mankind come true. We need to notice here that the rational utilitarianism and wealth-pursuing activities should be encouraged, and the market economy is able to provide a

channel for the realization of these rational pursuits. Market economy can effectively exercise incentive mechanism in order to achieve a higher economic growth rate. National wealth comes from the high-efficient production. The high productivity of social labor can increase the wealth, and it will be a significant increase in the supply of goods. However, the normal operation of the market economy needs a favorable and sound legal system to provide protection. Otherwise, the regulatory role of economic leveraged on resources cannot be achieved.

Overall, the implementation of the market economy in China brings high economic performance. Meanwhile, its congenital deficiency is also exposed to the world, which is the market economy can achieve the best efficiency only if the whole country is able to synchronize its actions.

### **3 Walk Out of The Ideological Misunderstanding Area**

The modern society has almost completely different economic characteristics from free economy. From real life, people clearly realize that the development of the country would suffer if the law of the market economy fully takes the place of other laws and regulations. As a result, we should make an in-depth understanding of the market economy. The reasonable development of the means of production is the main way of the future social construction. It needs to further emancipate the mind, to break through the Western neoliberalism, and to correctly distinguish the real cause of the social conflict and benefits friction and then to seek reasonable solutions.

#### **3.1 Reduce the Opportunity Cost of Market Failure**

Western economic theory summarizes the market economy as the abstract pair of supply and demand curves. These two curves rise and fall relative to each other under the guidance of price signals, and finally produce a balanced intersection point. This conclusion is only valid under some assumptions. In fact, the growth of socio-economic equilibrium involves many factors. The price leverage is only one aspect. Therefore, not only is the Western economic theory defective, but the market mechanism itself is not perfect. The argument of pan marketization, however, extensively boasts the function of the market mechanism, propagandizing the enforcement of fierce economic competition, survival of the fittest that help the country quickly reaches the restructuring of the international economic institution. In some places, the actual reality after the “successful” enforcement is ineffective, numerous errors happened in the process.

First, survival of the fittest means fierce economic competition in the market economy. The result of strong implementation of economic competition can only exacerbate the polarization on the distribution of benefits, and increase the disparity between the rich and the poor, which is clearly not consistent with China’s national traditions. Second, the coercive implementation of some global, long-term, and public-service socio-economic activities and investment do not receive the expected effectiveness. Moreover, the pursuit of maximum profits of microcosmic subjects is contradictory to the macroscopic interests. The pursuit of local and short-term interests often damages the global and long-term interests, which deviates from the direction of the important thought of the “Three Represents”. Third, the hysteresis quality of the market price signals can mislead the

resource allocation on some production projects or cannot meet the market demand, or squander valuable resources. This put China, which has a large population and fewer resources per capita, at a disadvantage. Fourth, the market mechanism guiding the spiritual, cultural, and political life is not only ineffective, but also misleading. Taking a radical way to implement market economy is easily prone to breed corruption, because it is a by-product of pan behaviors. In short, the market economy is not an omnipotent economic form. We must be acutely aware of its congenital defects

Government must deal with the problems generated by market failure that cannot be solved by the market itself, particularly in the public goods. In the spring of 2006, China released the people's livelihood index, a Chinese public environmental protection index, for the first time. It offers the public reliable and exact information to the consequence of market failure. More than half of the public consider air pollution caused by industrial pollution as the most serious environmental problem; environmental rights the public understands are the quiet right and the clean water right; the most common way people complain about environmental issues is to reflect the situation to the neighborhood committee or street office (Gu, 2006).

The mere implementation of the market economy cannot handle the economic contradictions and problems in China. According to the report, "build the indicator system of people's livelihood index, the preliminary findings and policy recommendations", released by the NPC Financial and Economic Committee Research Group in 2011, there is not a single positive correlation between economic development indicators and overall human development level. The indicator system of people's livelihood index contains four primary indicators, including the residential living, ecological environment, social environment and public services. The system is composed of two parts, objective indicators and subjective indicators. Objective indicators use the data from governmental statistics, accounting for 70% of the people's livelihood index; subjective indicators obtained mainly through questionnaires, accounting for 30%. A combination of both is exactly the people's livelihood index reflecting the local people's livelihood development status (Zhao Haijuan, 2011).

The assertion that market economy cannot save China's economic contradictions does not mean that we are against the market economy. In effect, people do recognize that some positive features of the market economy inspire the wealth growth. What people are against is the argument of American-style free market economy. It is the narrow and one-sided subjectivity theory of market economy. Eichner, an American economist, indicated in his book "Why Economics is not yet a Science" that the indifference curve, the equal product curve, the supply curve and the marginal product curve in the Western economic theory have theoretical defects. However, they are the basic theoretical framework of microeconomics, the basis of macroeconomics (Eichner, 1983). In other words, the entire Western economic theory system is to collapse if these four parts cannot be verified.

Eichner indicates that the most surprising thing is that economists have not yet confirmed the four theoretical structures in practice, although they are in such an important position (Eichner, 1983). These words not only represent his personal opinion, but reveal the very nature of the existing reality. Although the deficiencies of market mechanism cannot be cleared by work force, we can proactively reduce the opportunity cost brought by these defects, such as correct understanding and active prevention. The economic ideological trend of pan marketization has affected China's reform and has misled the economic works, losing plenty of high-value opportunities to the society. This work is by no means the pure academic affair in academia that uncovers that kind of wrong-preaching and



gorgeously camouflaged coat, and reduces the opportunity cost it produces, but has serious social and political significance. China should take the road of socialist market economy full of local characteristics, a development road that balances society and market economy. When developing the market economy, the country cannot ignore social construction activities of other non-market economy.

### **3.2 Clean up the Fallacy of Neo-liberalism**

Varying contemporary market organizations exert their influences through a series of formal institutional arrangements, rules and traditions. The developed market economy in western countries is the result of institutional evolution in several hundred years. The process is full of twists and turns. It also derives a variety of economic theory schools. These different views of economic schools sum up the experience and lessons the economic institutions of capitalism had experienced, and put forward development recommendations in line with different circumstances of capitalist system. For example, the neo-liberalism propagandizes the omnipotence of private ownership market economy to the utmost, attacks on government and intervenes in economic activities (Alan Haworth, 1994). Without a doubt, the capitalist ideology contained in this theoretical system is very clear and has a dual purpose.

On the one hand, it plays a positive role with respect to the unity and stability of capitalist society. On the other hand, it exerts destructive and disintegrative effects on the socialism, the antithesis of capitalism. However, the argument of pan marketization insists on the pursuit of neoliberalism, and openly preaches the promotion of reform. We cannot deny the fact that this is actually a way that brings some of the capitalist system into China. Cleaning up the neoliberalism is to resist the erosion of capitalism, and to establish a socialist market economy. But for China, it is a difficult task that, within a short period of time, achieves the level of the west which has developed for several hundred years. Designing a series of possible systems not only needs to participate in the design procedures, the more important is to create specific conditions for cultivating them. Reform is similar to the reposition of institutional arrangements. It is a great pioneering work, and has great significance without doubt.

However, reform will sometimes meets with difficulties, even get into trouble. Each far-reaching and significant reform happened in the Chinese history, no matter radical or progressive, is inevitably accompanied with exceptionally difficult situation. In this case, the cost and various types of risks of reform will undoubtedly increase. The semblance of reform, at this moment, appears to be in a state of stagnation. However, it is very necessary and extremely useful. Reform is somewhat similar to mountain climbing. A climber needs a rest to stop for a breather in order to re-ascend. Therefore, it is necessary to put on the brakes to decline the excessive speed of development. The buffer period provide a chance for people to reflect about the current situation and to resolve conflicts arisen in the process of reform. For example, it is necessary to let the rich deeply understand the sufferings of the poor, and to let them know that paying back to society is a good merit. Conversely, the poor also have the opportunity to fully understand the bitter side of starting a business that the rich had tasted. Naturally, the poor will not look upon rich men with hatred and are willingness to hard work to become well-off. The high-quality development is worth waiting, if we can build a harmonious relationship of mutual respect between these people.

Therefore, we might call it a buffer period in the early reform process of the “Twelfth

Five-Year”. Those practices including reform reflection, experience summarization and policies adjustment are actually to redesign the future reform process. The reform is linked closely with the future and destiny of China, so we need to keep sober all the time. Chinese people have recognized that the “Twelfth Five-Year” plan cannot be successfully conducted without caution and courage. Harmony is prior to development. The future is bright with harmonious development.

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