Free Enterprise in China – with apologies to Alexis de Tocqueville
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Introduction

This is a paper about my experiences on a recent month-long trip to China. This report is not intended to be scholarly – merely impressions after spending a very short time in China. Most of the things I will discuss are either things that I saw, or things that I learned while in China. Where I have used sources, I have referenced them in footnotes. When Alexis de Tocqueville wrote about the United States in the 1830s, he had spent 18 months here in the 1830s. I spent 1/18 of that time in China, and my observations are considerably less informed than his. However, I hope this will give the reader a feel for what one might find in China. Recognizing that the Chinese economy and society are among the most rapidly changing on the face of the earth, many of these observations will be obsolete by the time this paper is published.

To summarize my experiences in China, I found China to be a very interesting country, and the people were uniformly warm and friendly to me. They often took pity on us poor dumb Americans by keeping our groups out of trouble when we didn’t recognize the potential for problems. One of these instances involved our Beijing tour guide, Ms. Tan. During our first day’s lunch, one of the students said that he would just drink water. Ms. Tan shook her head vigorously, and said, “No! No! No! You don’t want to do that!” We found out later that Chinese tap water is not drinkable for westerners.

I begin this paper with a blatant “plug” for our China Internship program, and then move on to discuss some general observations about China’s society. In the remaining parts of the paper, I discuss the government’s role in the Chinese economy, the impact of economic reform, and conclude with a series of observations about specific topics in no particular order.

But First, a Word from our Sponsor: UWSP’s China Internship Program

In June 2005, I had the privilege and pleasure of leading 7 students on the China Internship Program. As part of this program, students spend an entire month in China. The first few days are spent sightseeing in Beijing. Then the students fly to Chengdu, a city of approximately 11 million people, which is considered a medium sized city by Chinese standards. This city has few tourist attractions although Chengdu is the city that most tourists going to Tibet pass through. For the 3 weeks the students are in Chengdu, they are essentially “working stiffs” who have to deal with the day-to-day challenges the average person has to deal with in China: getting to and from work, eating, getting their laundry done, etc. At work, students must try to get things done in an extremely foreign environment. This is a near total immersion into the Chinese business world.
This program is virtually unique. Though there are many study abroad programs in China, most of them are historically and culturally oriented. Our program gives students who speak little or no Chinese the opportunity to understand the nature of Chinese business, the Chinese economy, and the Chinese people. I believe that any student who will work for a company that does business in the global marketplace should participate in one of the many international programs. Further, I believe that businesses should consider hiring students who can help them compete in the global marketplace. UWSP ranks in the top 20 nationally in percentage of students who engage in an international experience. Personally, I believe this is an underutilized resource for Central Wisconsin’s business community.

Now that the advertisement is complete let’s discuss my experiences in China. I will begin with a few observations about China’s society in general.

**Society in General**

There were two things I thought I was prepared for when I went to China: the number of people, and how foreign things would be. Unfortunately, I discovered that I was not ready for either. Although one can visit major cities in the U.S., it is difficult for a westerner to be prepared for the population density in China’s cities. Doing anything in a Chinese city is a very competitive exercise. In merely moving from point A to point B, people have to fight the crowds and jostle for position. Traffic is a truly fluid thing with little regard to the normal rules of the road. Although the Chinese normally drive on the right-hand side of the road, the left-hand lane, ordinarily reserved for oncoming traffic, is viewed by the Chinese driver as simply another option for forward movement unless confronted head-on by a larger vehicle. Additionally, the westerner is unprepared for the sheer volume and variety of the vehicles available for transportation. These range from human-powered rickshaws to large diesel trucks and luxury Mercedes automobiles. However, the greatest number of vehicles I encountered were bicycles and electric-powered scooters. I found the scooters the most dangerous because they are virtually silent, and they are fast – with a top speed of around 25 miles per hour. All this occurs in a setting that is extremely alien to the average westerner.

Spoken language is very different to western ears. In Chinese, each “word” has its own intonation which can change the meaning. Also, the Chinese language uses words in combinations that may change the meaning of a given word. Add to this the apparent requirement that Chinese must be spoken rapidly and forcefully, and the average westerner gets the impression that everybody is arguing all of the time.¹ Exacerbating the problem for westerners is that very few people in China speak English. Not only is this true in smaller cities such as

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¹ As frustrating as the language problems were, I enjoyed many English-language movies dubbed in Chinese. These included *Kramer vs. Kramer*, *Gosford Park*, *The Caine Mutiny*, *On the Waterfront*, and the television show *Mythbusters* although this is probably no more peculiar than a Chinese speaking person seeing *Crouching Tiger, Hidden Dragon* dubbed in English.
Chengdu, but it is also true in Beijing. In Beijing, we stayed in a four-star hotel catering to foreigners, and we found that about one person in five spoke English.

The written language is also unintelligible to westerners. In western languages, there are letters in an alphabet that are combined to make words. As a result, westerners can often understand things on a basic level. In Chinese, the language is made up of pictographs that are combined to convey concepts. You can rarely point to a pictograph and say that means, for example, Subway the way you can in French or Spanish. Also, to be fundamentally literate in Chinese requires knowledge of at least 3,000 pictographs; such literacy does not occur until the early teenage years.

Although English is not in common use, virtually every street sign is translated into English. As someone who spoke only English, it was far easier for me to navigate in China than it would be for a person who spoke only Chinese to navigate in the U.S. Unfortunately, many of these signs are literally translated from Chinese into English. Westerners have, somewhat arrogantly, named this type of English Chinglish. My favorite translated sign was at the home of a famous poet in Chengdu. It read, “Here water is making very deeply! Be Carefully!” I am sure English translated directly into Chinese would produce similar humorous results.

One interesting aspect of China is that the people have a generally positive view of Americans. This is especially true in Chengdu. They still have memories of World War II, which they call the “War of Japanese Aggression,” and of the Flying Tigers stationed in Yunnan province just south of Sichuan province where our students worked. They are also very interested in our political process. I have never been asked as directly who I supported during the 2004 presidential election. I generally responded with jokes such as “One of our cherished liberties is the right not to talk politics.” My friends in China found this very puzzling.

Smoking is much more prevalent in China than in the U.S. If you ask for a nonsmoking table at a restraint, the waiter will simply remove the ashtray. People smoke all of the time everywhere. Finally, most westerners think of China as a very ancient society. In many ways this is true, but most of the things people think of as typically Chinese were built at the time of the European Renaissance or somewhat earlier. While the Great Wall was begun more than 2,000 years ago, the Forbidden City was constructed in the late 14th and early 15th centuries. Although these are interesting observations about China’s society in general, the manner in which the Chinese practice free enterprise in the context of its Communist governmental structure is even more interesting.

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2 Someone who is fundamentally literate is able to read and write enough to operate in the business world as most adults would – the ability read and understand directions, newspapers, contracts, etc.
Communism versus Capitalism: the Chinese Government

The government in China is a communist, one-party state. Only Communist Party members are allowed to have any kind of governmental position, and this requirement means that quite minor governmental officials must subscribe to the ideals of the Communist Party. In China, the news is censored, information is suppressed, and governmental officials must be atheists. In contrast however, the Chinese economy is extremely capitalistic.

The safety net we associate with governmental programs is virtually nonexistent in China. There is enough support to provide the basic necessities such as food and shelter, but not much else. During our last weekend in Chengdu, I had the “pleasure” of arranging the medical care for one of our students at 1:30 a.m. on a Sunday (it’s a long story), and the hospital wanted cash on the spot. I thought that this was because I am a westerner, but my tour guide explained that all medical care must be paid for in this manner. She told me about how angry her parents were when she helped to pay for an aunt’s surgery.

The anger of the tour guide’s parents is understandable because China is just now beginning to experiment with social security. Currently, parents expect their children to support them in their old age. Due to the “one child” policy in China, there are looming demographics imbalances. In the future, there will be relatively very few young people to support a large aging population. This could be further exacerbated by potential future gender imbalances due to such things as allegedly more frequent adoption (by westerners) of female children than male children, and the alleged choice of parents to end pregnancies that would result in the birth of girls more frequently than those pregnancies that would result in the birth of boys. China may need to implement more safety net programs for its society, or these future demographic imbalances, coupled with such problems as income inequity (discussed later), may put pressure on the Chinese society that could lead to serious future consequences.

In summary, China exhibits a seeming schizophrenia between the way its government operates and the way individuals operate in their private lives. This is explained by the 1962 quote from Deng Xiaoping,3 "It doesn't matter whether your cat is black or white, as long as it catches mice." This shows China’s extreme commitment to pragmatism. In the next section, I will discuss how well China’s free-enterprise cat works.

Capitalism versus Communism: Some General Observations about the Economy

One of our first experiences in Beijing was our Hutong4 tour. This is a tour of some of the backstreets of Beijing to see how the average Chinese person lives. It is probably more accurate to say that this is how some Chinese people lived in

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3 See http://pltprk12.nj.us/~ewood/China2/politicalculture.htm
4 In Chinese hutong literally means Small Street.
Beijing a number of years ago because now most people in Beijing live in apartment buildings. However, as an economist, the most interesting things I saw related to the entrepreneurial nature of the Chinese economy and culture. Every second or third door had a small shop selling virtually everything someone would need – meat, electronics, clothes, produce, etc. Further, every sale is a negotiation. There is a clear tradeoff between the price spent on an item and the time spent negotiating what the buyer will pay, and most Chinese people are willing to spend their time negotiating for a lower price. Virtually all transactions are cash transactions. This combination of widespread entrepreneurial activity combined with the “cash is king” attitude of the Chinese consumer makes government regulation of the Chinese economy virtually non-existent.

This lack of governmental influence even extends to such things as paying taxes. For example, China has implemented a tax collection strategy that is part lottery and part public service campaign. When you receive the bill for dinner in a restaurant in China, there is a scratch-off portion. If you scratch it off, and reveal a number, you receive the amount listed in Yuan, the Chinese currency. If there is no number, the bill says, “Pay Your Taxes,” and you receive no money. From my discussions with friends in China, my impression is that the Chinese bureaucracy has virtually the same capabilities (technology, impact, etc.) as it did 20 years ago. Thus China has the paradox of a communist government with a very small impact on the marketplace. At the same time, the U.S. government’s impact on our economy is growing with such regulatory measures as Sarbanes-Oxley. In China, there either are no regulatory agencies such as the EPA\textsuperscript{5}, FTC, and FDA. Other agencies are unable have much of an impact on the economy. As a result, the commercials on Chinese television offer an amazing variety of products and make extravagant claims about the products advertised.

By far, most of these products are purported to improve physical appearance. Such products include breast augmentation products (pills, ointments and electrical devices), and even a product, similar to the rack (the medieval torture device), which is supposed to make the user taller. However, more products are offered for weight loss than for anything else. Weight loss products include pills, exercise equipment, and electrical devices designed to melt fat. This concern about obesity can be traced to the way China’s economic reform was conducted.

The first beneficiaries of economic liberalization were farmers. Rather than having the government control their output, they could grow their crops in the most efficient manner possible in order to make money. As prices were allowed to increase, more farmers began producing more efficiently, and as agricultural output increased, prices dropped. Consequently, food became abundant and relatively cheap. Combine this with the fact that China has living memory of famine, and China may fall victim to a future obesity epidemic similar to our current obesity epidemic. While I was in China there were several English-language government-controlled news reports about the growing obesity problem in China.

\textsuperscript{5} Chinese cities are extremely smoggy, and its rivers are also polluted.
Resource Prices and Currency Exchange Rates

China is a very inexpensive country by western standards. In part, this due to the exchange rates maintained by the Chinese government. When I was in China, the exchange rate was 8.2641 RMB\(^6\) (Yuan). This was recently reduced to about 8.0821,\(^7\) a reduction of approximately 2 percent. It is generally conceded that the Chinese currency is undervalued relative to the rest of the world’s currencies. In part, this is clearly governmental policy, and represents one of the few areas of effective control by the government. However, the other reason prices are cheap in China is due to the nature of the labor market. They have a large workforce, and this has the effect of lowering wages.

The impacts of low Chinese labor prices are easy to see. For example, if there is a water main break in a city in Wisconsin, a backhoe is dispatched with at most 2 or 3 workers. If there is a water main break in Beijing, 20-30 workers are dispatched with picks and shovels. When you eat at a restaurant in China, you will be greeted by 4 or 5 people, and be served by 2 or 3 different people, and have a waiter or waitress stay at your table during your entire meal. Finally, when you go anywhere in the major cities, you will find people directing pedestrians, and other people sweeping the streets by hand with very large brooms. These public jobs are a Chinese version of W2, and the people doing these jobs are very happy to have them. As Thomas L. Friedman says in his book *The World is Flat*, “People in India and China are starving for your job.”

This hunger for jobs produces a remarkable competitiveness in the Chinese workforce that is translated into China’s economy in general. The notion espoused by some in the U.S. is that children should play games and not keep score is an idea that finds little resonance among the people I met in China.

Interestingly, many of the Chinese people I talked to considered western businesses unfair competitors due to their reliance on capital for production. Their view was, “Yes, we don’t pay our workers much, but we do pay them. Machines work essentially for free, are more precise than human workers, and aren’t subject to fatigue, old age, etc.” These conflicting views confirm the economic view that resources prices (governed by supply and demand) have the power to exert a great influence on the economic landscape. So far, this paper has surveyed the Chinese economic landscape. In the following paragraphs are some general observations presented in no particular order that flow directly from the information presented above.

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\(^6\) RMB stands for *Renminbi*, or Peoples’ Currency.  
See [http://www.google.com/search?hl=en&lr=&q=RMB](http://www.google.com/search?hl=en&lr=&q=RMB)

\(^7\) I found this exchange rate on [http://www.google.com/search?hl=en&lr=&q=RMB](http://www.google.com/search?hl=en&lr=&q=RMB)
Finance – Cash is King

The one industry heavily regulated in China is the financial services industry. The types of transactions U.S. consumers regularly perform (e.g., electronic payment, debit card payment, wire transfers, simple checking transactions, etc.) are extremely rare in China. As I stated before, “Cash is king.” Consequently, people must go to elaborate means to protect their cash. Under my shirt, I wore a money belt and a purse that went around my neck and under my arm. When I paid my Chinese counterpart in Chengdu, we had to find a bank that would cash a lot of traveler’s checks. Then, my colleague had to go home to put the money in a safe. I asked my counterpart why UWSP couldn’t simply send a wire transfer to Sichuan University. He responded that the foreign student and faculty offices preferred cash. As you can see, these kinds of cash transactions are very difficult to regulate.

State-Owned/Controlled Businesses

Western analysts often state their concern that there are many Chinese businesses that are either wholly owned by the government, or enjoy large governmental subsidies. For example, there was considerable concern about the attempted merger with Unocal by the Chinese National Oil Company (CNOOC). Although we are correctly concerned about the governmental subsidies to some Chinese companies, I believe this concern may cause us to ignore the real risks associated with competing against Chinese businesses. The real powerhouses of the Chinese economy are the small and medium-sized enterprises (SME’s). These businesses are highly competitive, and when coupled with the entrepreneurial spirit of the Chinese people, there is the potential for serious future competition.

Guan Xi, and the Importance of Relationships

In order to get along in China, everyone practices Guan Xi. This concept is generally translated as developing relationships prior to doing business. The idea is that first we become friends and once we develop a level of trust, then we can do business.

This approach was developed due to historic inefficiencies in the flow of information within the Chinese economy, and because contracts were very difficult to enforce. Traditionally, there were no Chinese credit agencies. Also, ancient Chinese courts practiced a severe method of tort reform; if a plaintiff brought an unworthy case, the court might punish the plaintiff. Such punishments might include beatings, forfeiture of property and execution. Because of these factors, the potential for fraud was rampant. Thus, guan xi is a way of protecting the parties by exacting a cost to the reputation of any party who reneged on the contract.

8 Given Chengdu’s heat neither of these items smells like a rose.
At its most benign, guan xi is similar to our concept of networking. However, at its least benign, it may force partners to engage in such things as bribery and nepotism, and can result in patronage schemes worthy of Tammany Hall. Also, your competitor may have a relationship with a patron more powerful than yours, and this gives your competitor an unfair advantage. Finally, consider the costs associated with not having a relationship in such a business environment. The unspoken implication of not having a patron is that you are fair game. Our students observed this when they went shopping, and they tried to bargain with the vendors. One student said, “I need to go consult with one of my Chinese friends.” Upon hearing this, the vendor dropped her price by more than 100 Yuan. However, this approach didn’t work in all situations. One vendor responded, “Oh, you have Chinese friends? So do I,” and summoned a large tough-looking man. Our student beat a hasty retreat, and the vendor lost his sale.

Income Inequity

One side effect of China’s economic liberalization is income inequity. The Chinese are very concerned about this. There are many plans under consideration about how to reduce income disparities. However, the ineffectiveness of the Chinese government makes these plans unlikely to come to fruition. A government that cannot collect its taxes is unlikely to redistribute income or wealth. During the Cultural Revolution, income, wealth and occupational redistribution were attempted using the severest methods possible. These attempts at redistribution resulted in the widespread disruption of the Chinese economy and social structure. I believe that this kind of disruption to Chinese society is something that few would be willing to risk. Further, it is impossible to dispute the positive influence of economic reform in China, and few Chinese citizens would want to go back to the days prior to reform. Consequently, I expect that while there will be a lot of hand-wringing, very little real income redistribution will occur.

Alcohol

In China attitudes toward alcohol are very similar to U.S. attitudes in the 1950’s and 1960’s. It is not at all uncommon to have alcohol served during the lunch hour. My counterpart at Sichuan University was quite fond of rice “wine,” which was really more like rice vodka. Its alcohol content of this liquor is 54 percent. The standard toast sounds to western ears like the word Gambay, and is roughly translated as, “Bottoms Up!” Although most people drink considerably in China, I never saw anyone pressured to drink. Additionally, Chinese laws concerning DWI are quite severe, and I never saw any of my Chinese colleagues drive after drinking.

In addition to their rice “vodka,” China produces many excellent beers. Everyone knows about Tsingtao, but all of the beer I consumed in China was excellent. In China, their view of beer is similar to the way Americans viewed beer during the
temperance era – beer was considered the drink of moderation. Sometimes, my Chinese counterparts would drink beer to sober up after drinking too much rice “vodka.”

Piracy

Our students found that virtually all of the software used at their place of employment was pirated. Further, product piracy is practiced in many different forms. Consumers can purchase any kind of knockoff from Rolexes to fake ancient Chinese artifacts. I warned our students against trying to make a killing by buying inexpensive Chinese goods. A good rule of thumb is that if you like something, and the price is acceptable, buy it. Westerners often become rather smug when discussing the piracy of our products and software. However, one of my Chinese friends pointed out that the western age of mercantilism, the renaissance and the age of exploration were, in large part, fueled by Chinese inventions including movable type, gunpowder, paper money, and large sailing ships.

Conclusion

In this paper I have reviewed some of my experiences in China. These experiences have been so different and varied that it has been very difficult to know what to include and what to exclude. Several people have asked me if I would go on this trip again. The answer is yes. I will lead UWSP’s 2006 China Internship Program. If you know of anyone who is interested in going, please have them contact me.