Free Enterprise in China – the Experiment Continues

Gary Mullins, Ph.D.
Professor of Business
University of Wisconsin-Stevens Point

Abstract: After 25 years of liberalization, China’s economy has rapidly evolved in response to increased opportunities and exposure to the global marketplace. As the leader of UWSP's Business Internship in China, I have had the opportunity to witness the dramatic changes that have occurred in China’s business environment over the last five years. During this time period, China has had to deal with challenges that include the Olympics and the accompanying world attention, ethnic unrest, H1N1, and the nation’s first experience with deep global recession. This report will examine recent developments in the Chinese economy and highlight the effects of these developments on economic relationships with the Central Wisconsin region.

INTRODUCTION

Since 2005, I have been privileged to lead UWSP's China internship program three times – in 2005, 2006 and 2009. The China internship program usually takes between 10 and 20 students to China for a month during the summer. For the first few days, we tour the sights of Beijing. Then we fly to Chengdu a major city near Tibet. In Chengdu, the students spend three weeks working for a Chinese business, government agency or university.

This program is a life changing experience for our students. They experience the Chinese economy, and culture from the inside.

During my visits, I have noticed significant changes in the Chinese economy. I have also noticed an increase in the importance of international trade for Wisconsin and the nation. This paper reviews some impressions about these changes. These observations are not meant to be scholarly or definitive, but are based on an economist’s experiences within China. The primary sources are discussions with Chinese colleagues and other Chinese people I have come into contact with.

I begin with a brief discussion of China’s economic history beginning with the establishment of the People’s Republic of China in 1949 and later economic liberalization. I then review the impact of the liberalization on China’s economy, growth rate and the impact of the global recession on China as well as its impact on China’s economic position globally. I discuss some changes to China’s economy, and China’s economic relationship with the US and Wisconsin. I conclude by talking about the political and cultural environment and how that affects a westerner doing business in China.
**HISTORY**

“The Chinese people have stood up!” With these words Mao Zedong (or Mao Tse Tung) proclaimed the establishment of the People’s Republic of China from Tiananmen Square on October 1, 1949.1 Between 1949 and the late 1970’s, the government used centrally planned economic programs designed to grow the Chinese economy into an industrial and agricultural powerhouse.

These programs universally failed.

One of the most disastrous examples of this failure was *China’s Great Leap Forward*. This program attempted to double China’s production of high-quality steel within a year. Local officials would often lie if they had not met production quotas to avoid punishment. One of my Chinese colleagues described how his parents and other local households as well as farmers brought pots, pans, knives and metal farm implements to the local steel furnace set up in a neighbor’s backyard. Without skills in metallurgy, what little steel that was produced was of very low quality. With the loss of farm implements, the plan had the unintended effect of causing widespread food shortages and famine.

As a reaction to such failures, Deng Xiaoping began the process of economic liberalization in the late 1970’s. Deng famously declared in 1962, “It doesn’t matter if a cat is white or black so long as it catches mice.” This was Deng’s argument for loosening government control, suggesting that China should focus on economic results rather than Marxist doctrinal purity. He later stated, “Poverty is not socialism. To be rich is glorious!” This is in direct contrast to Marx’s maxim, “From each according to his ability; to each according to his need.” In contrast to previous programs, this economic liberalization has made China the economic growth engine we observe today.

It is doubtful that Mao would recognize the China we see today. Although he might be pleased with China’s economic power and growth, it is certain that he would strenuously object to the methods used to create it.

**RECESSION? WHAT RECESSION?**

Because of liberalization, China continues to make great strides economically. China is currently third in GDP with $3.9 trillion annually. This puts them behind only the US ($14.2 trillion) and Japan ($4.9 trillion) and ahead of Germany.2 It was expected that China would overtake Germany, but that it would happen more slowly. China moved ahead of Germany so quickly because the recession caused Germany’s economy to decline, while at the

---

same time it caused China’s economy to grow albeit at a slower rate. Thus the global recession quickened China’s GDP rise relative to other industrialized nations. China’s GDP growth rate for 2008 was approximately 9 percent, which is down from the 13 percent growth rate experienced in 2007. Although China ranks 16th worldwide in GDP growth, theirs is the largest growth rate of any of the large world economies. For example, the highest GDP growth rate was experienced in Bhutan (21 percent)3 with a total GDP of $1.4 trillion.2

China’s second quarter growth rate has been reported at 7.9 percent and the Chinese government has targeted GDP growth for 2009 at 8 percent.4 According to one of my colleagues, this high level of growth is, in part, due to the Chinese stimulus package that focuses its spending in 2009 and early 2010. He stated, “One of the greatest strengths of a communist form of government is that the government can simply command projects to be undertaken without debate or dissent. He added, “Of course, that is one of our greatest weaknesses as well.”

In the past, economic growth flourished most along the coast while the interior experienced slower growth. Many people who migrated to the coasts to find employment are returning to the interior. Many Chinese have found that high levels of economic growth in the coastal regions tend to fluctuate with global economic activity, but slower interior growth rates are not as dependent on the vagaries of the global economy. Consequently, workers are returning to the interior after previous migrations to the coasts.

Compared to the US’s GDP growth, China’s numbers hardly seems recessionary; however, unemployment has risen due to falling global demand for Chinese exports that occurred with the recession.5

From a purely anecdotal perspective our students noticed a marked increase in peddlers and beggars during their sightseeing and their internship responsibilities. An ongoing observation by our students is that China favors labor over capital because of labor’s relative cheapness due to their large labor force. However, students also noticed increased labor usage in such areas as street cleaning and construction. A student who worked on Wisconsin’s highways was particularly amazed at the road construction crews. We saw a pickup truck disgorging 25 road workers, each carrying hand tools. Some had typical hardhats, but others had bicycle helmets and many had no helmets at all. High GDP growth rates are necessary to maintain employment of China’s workforce until population controls take effect. This type of activity is not new. From ancient times, China used human power as a replacement for capital equipment.

What is new are the changes in financial innovation.

4 http://chinadigitaltimes.net/2009/07/john-h-makin-china-bogus-boom/
5 http://www.nytimes.com/2009/02/06/business/worldbusiness/06yuan.html
ECONOMIC CHANGES – FINANCIAL INNOVATION

Last summer was my third trip to China in four years. In the past, I observed that cash was king and that virtually all transactions regardless of size were cash transactions. During my visit this summer, I noticed that cash was not as important as it had been in the past. Cash is still king, but credit/debit cards appear to be mounting serious challenges to the king’s dominance. This is especially true for younger people and for women.

Young people are typically early adopters in any society. In China, women are relative newcomers to the Chinese consumer economy and do not seem to be as ingrained in the old methods of doing business.

The primary reason for the increased usage of credit and debit cards is that they represent a considerable convenience when compared to cash. The largest RMB note is the 100-Yuan note. This note represents only about $6 worth of purchasing power.

Older men are more accustomed to the past modes of doing business, and do not consider carrying large amounts of cash as an inconvenience that women and young people do. One of my colleagues laughed and said, “I have never thought that having a lot of cash a burden!” He then paraphrased Adam Smith by saying, “Cash is a steady friend!”6 This financial innovation has apparently completely bypassed checking, much as cellular technology has bypassed landlines among some young people in the US.

One result of such innovation may be to regularize pricing for transactions. In most transactions, the Chinese consumer expects to bargain with the seller. The seller has the opportunity for perfect price discrimination by selling the same product at a different price for each customer. The consumer has the opportunity to exchange time spent bargaining for a lower price. For convenience-minded shoppers, such bargaining represents a considerable drain on one’s time. Further, the growth in the average consumer’s income increases the opportunity costs of bargaining, making it less desirable for consumers to bargain. Although financial innovation is the greatest change I observed, I also noticed that the government has begun making its presence felt in the marketplace.

GOVERNMENTAL CONTROL OF THE MARKETPLACE

One byproduct of using credit/debit cards may be to increase the government’s control over China’s economy – both its financial marketplace as well as the marketplace for goods. China continues to have trouble collecting taxes owed by its populace – in part due to the largely unregulated, cash economy. In the future, China may find it easier to determine income for tax

purposes by monitoring a few credit card companies rather than having to regulate trillions of
Yuan worth of cash transactions.
During previous visits, I remarked on the openness of the Chinese marketplace for goods. In
China, entrepreneurship is highly valued. There are so many small businesses being started
that it is very difficult for the government to regulate business. Although this lack of regulation
promotes small businesses’ growth, it has also caused problems concerning the quality of
Chinese manufactured goods. Two examples are the recent problems with lead contamination
of Chinese goods exported to the US (especially toys) and with melamine contamination in
Chinese milk, which resulted in the deaths of at least 6 children. My colleagues reported that
the government is increasing its regulation of consumer goods because of these and similar
(but less-publicized) events, including stiff sanctions (including death sentences) for milk
company executives and middlemen as a result of the melamine contamination.7

However, my colleagues report that the government’s regulatory attitude appears to be a
reaction to events, rather than as a systematic set of regulations with regulatory bodies to
enforce them.

Overall, my fellow economists agree that China has reaped considerable gains as a result of the
liberalization of its economy. What about China’s economic relationship to the US in general
and to Wisconsin in particular?

THE US’S RELATIONSHIP WITH CHINA

In the past, the US had very high trade deficits with China. However, trade deficits alone do not
tell the whole story. Economics suggest that when currency flows from one country to another,
it must flow back by buying something from the country that contributed the currency.
Perhaps some remember the great concern with the Japanese trade deficits in the 1980’s. At
that time, Japan purchased real estate in the US – including the Rockefeller Center and the
Pebble Beach Golf Course. The predicted ruin of our economy did not materialize.

Unlike the Japanese, China has used her US currency to purchase debt.8 With a looming multi-
billion dollar stimulus package, the US will need customers to buy our debt. Of course, there
are probably some American homeowners who wish China would follow Japan’s example so
that the Chinese would purchase US property and thus help the US real estate market.

China’s reasons for purchasing our debt have to do with the self-interest of both parties. Our
self interest is served because their purchase of our debt helps our debt maintain its value. It
also helps the US by supporting the stimulus in particular and the US economy in general. Their
self interest is served because they maintain the buying power of their second-largest trading
partner (behind Japan). The Chinese economists I talked to all agree that China wants to see

the US’s economy flourishing. Further, our debt provides China with a relatively safe investment for their dollars.

Recently, there has been less concern about our trade deficit with China. This is because our 2009 trade deficit is on track to decline relative to 2008.\(^9\) This is typical during a recession because spending in general declines. Additionally, the trade deficit does not seem to be as great a concern during a global recession.

Despite the recession and trade deficits the US will continue its trade with China because it is in the interest of both countries to trade.

**WISCONSIN’S RELATIONSHIP WITH CHINA**

As I mentioned in my introduction, China ranks third in purchasing Wisconsin’s exports behind Canada and Mexico.\(^10\) The importance of the global economy to Wisconsin’s economic health was illustrated during a series of listening sessions that UWSP’s Division of Business and Economics held with businesses, law firms, government agencies and community groups. These listening sessions occurred during the summer of 2008 in a variety of locations. One item many of the companies had in common was their reliance on the global economy.

Some companies purchased goods internationally while others sold to international customers. The striking thing was that many of the businesses that traded internationally were quite small in size.

Wisconsin’s relationship to China also was highlighted in the 2006 Centergy report, which showed that China’s most efficient distribution route to the Midwest and beyond goes through Central Wisconsin by rail. Further, recent news reports have discussed China’s demand for our dairy goods and our dairy technology.\(^11\)

Milk is one product sorely missed by our students during their internships. This is because dairy products are relatively new to China’s grocery shelves. During our 2005 trip, government-sponsored advertising encouraged milk consumption. The Chinese people have recognized that dairy products are a useful source of protein and other nutrients, especially for city dwellers.

Unfortunately, the primary dairy products offered in China are milk and dried milk. The milk currently available is mostly canned milk and is served either warm (room temperature) or heated. Most of our students try milk in China, but quickly stop drinking it because of the poor taste and quality. They also are discouraged by the way the milk is served. Further, concerns about milk purity (melamine contamination) suggest that the Chinese dairy industry has a lot to

\(^10\) [http://commerce.wi.gov/IE/IE-ExportData.html](http://commerce.wi.gov/IE/IE-ExportData.html)
learn from Wisconsin’s dairy industry. Finally, the lack of dairy production means that the dairy byproducts are almost nonexistent.

Other dairy products such as ice cream and ice cream products are available, but these products are relatively expensive because of high refrigeration costs. According to my colleagues in China, refrigerators are the next big-ticket item that Chinese consumers will desire. Refrigeration will allow for the production and distribution of dairy products as we experience them. Whether we are talking about manufactured goods or dairy products, all Wisconsin businesses operate in a global marketplace. Central Wisconsin’s economic health will be dictated, in part, by how well Wisconsin competes with the rest of the world and how well Wisconsin operates in the global marketplace.

Therefore, the question is, “How can Wisconsin compete effectively in the global marketplace?”

First, Wisconsinites must recognize that we operate in a global economy and that we benefit from global trade. Wisconsin’s exports total $20.5 billion – $1.2 billion worth of goods are exported to China alone. Further, local businesses have a share of this trade as our listening sessions revealed. Finally, we must have business leaders who understand global business.

**UWSP’S INTERNATIONAL BUSINESS PROGRAMS**

Some question whether we can compete in the global marketplace. UWSP’s Division of Business and Economics has taken steps to ensure our students have a thorough understanding and experience of the international economy. UWSP ranks first in the UW-system in percentage of students who have international experience and we rank in the top 20 nationally.

In business, we have offered international internships in such locations as Bosnia, Singapore, and Ireland. Each year we offer internships in London and China. These internships require students to learn about international economics and business from the inside. They require students to work in businesses, governmental agencies and universities. After completing one of these international experiences, students understand how foreign businesses work as well as their strengths and their weaknesses. They are required to report on how a US counterpart can most effectively compete with their host employers.

Not only do our programs teach students about the business and economy, they also learn about international political and cultural mindsets by making friends in their host countries.

**WHAT ABOUT POLITICAL LIBERALIZATION?**

Although participating in international programs increases a student’s understanding of the business, economy and culture of their host countries, perhaps an equally important change is

12 http://commerce.wi.gov/IE/IE-ExportData.html
our students’ renewed appreciation of their own country. In part they appreciate such things as familiar food, sanitary facilities, etc., but in part they come to the US with renewed appreciation of our political freedom.

China has had great success with economic liberalization, but the hoped-for political liberalization has not kept pace with the economic liberalization. My colleagues universally agree that China is a much freer country now. In the past, my colleagues had to deal with government informants in almost any gathering no matter how informal. A friend told me that at one time the government had declared that 15 percent of the Chinese people were counterrevolutionaries (i.e., opposed to the government). Therefore, each gathering that had more than 6 people had to designate 15 percent of the people attending as counterrevolutionaries and had to eject them from the meeting. My friend was once late to a faculty meeting because he had to leave to go to the restroom. In his absence he was designated as the counterrevolutionary (and ejected) because he was not there to argue. The general consensus is that people now have freedom of speech as long as they do not broadcast it too loudly.

The one area where China is marginally freer is religion. Any kind of profession of faith or proselytizing may be met with severe penalties. Further, atheism is still the official policy of the Chinese communist party, and religious beliefs may cause people to be excluded from party membership, governmental jobs, etc.

Ironically, the economic opportunity for people professing religious beliefs has been an unintended consequence of economic liberalization. In the past, religious beliefs excluded people from governmental jobs at a time when virtually all but the lowest level jobs were governmental jobs. Since liberalization, the non-governmental sector of the Chinese economy has grown significantly more than the governmental sector. Although the government still keeps a close eye on religious groups, people professing religious beliefs are not precluded from earning a good living precisely because not all jobs are controlled by the government. Therefore, economic liberalization has lessened the impact of economic repression of those holding religious beliefs.

In general, the reason for the government’s concern about proselytizing or any kind of broadcasting of dissenting opinions is that the government (and most Chinese people) are concerned with their country’s image – especially the country’s image abroad.

THE IMPORTANCE OF FACE

Based on my discussions with people from different walks of life, the Chinese people are quite proud of their country and of being Chinese. They are therefore very sensitive to anything that negatively portrays them or their country. As a result, information is heavily monitored and, at some times, censored. Consequently, there were some events that our students knew more about than the average Chinese person.
Prior to our going to certain locations, I assigned 5-minute reports on what we were about to see—its history, significance, etc. There were also reports that were purely historical in nature.13

If we were going to ride some distance from the hotel, the reports were given on the bus. During these reports, the tour guide listened very attentively (perhaps this was mere courtesy). If the sites were near our hotel, the students gave the reports in the dining room after breakfast. During these reports, the Chinese people in the dining room who understood English would walk by our table. Ostensibly they were going to get coffee or more food. They however tended to linger so that they could listen to our students.

A colleague told me that the average Chinese person might know about China’s ancient history, but would only know the government’s version of more recent events. He stated that this was probably true of the tour guide as well.

There are some signs that information is not as strictly controlled as it has been in the past. In 1976, there was an earthquake in which the death toll was approximately 4 times as great as the 2008 earthquake. The government limited information about the quake, which in turn restricted aid to the afflicted area. This restriction of aid may have increased the death toll.

Although there is some liberalization of information, it is not the virtually unfettered exchange of information we experience. This includes information on the internet. For example, Google’s home page looks considerably different in China. There is, however, a limited person-to-person internet. During our stay in Chengdu, there was a bus explosion that might have been the result of terrorist actions. None of the local news outlets carried the story until several days after the explosion. We found out about it from cab drivers. Cab drivers who had witnessed the explosion told other cabbies. Of course, anyone who has played the children’s game of party line can foresee the problems with this mode of information transfer.

**LAST 5 YEARS – OLYMPICS AND H1N1**

One result of the importance of face has been China’s reaction to the H1N1 virus. I believe their reaction is due to sensitivity to past criticism. One might say they are overly sensitive. Past criticism of the lack of governmental action in the SARS and Bird Flu outbreaks caused China to be very cautious about dealing with foreigners. We were monitored for symptoms immediately upon landing in Beijing and during our progression through the airport. We were almost quarantined in Chengdu, but were able to work out a compromise in which we did not come to our campus lodgings until we had been in China for 7 days without symptoms. Part of their concern was that the disease was brought by foreigners to China.

This concern about maintaining face coupled with China’s uneasy history with respect to the rest of the world causes a paradoxical attitude towards foreigners in general and towards

13 Prior to this trip almost none of our students knew who Mao was.
tourism in particular. Although the Chinese government is in favor of tourism and believes that they win friends through tourism, they are also somewhat uncomfortable with it because tourism brings in different ideas and influences.

From the foreigners’ viewpoint, tourism exposes us to Chinese attitudes that are just as unexpected. During our Beijing entry tour we visited the Bird’s Nest – the primary Olympic stadium. We asked our guide about the future of the Bird’s Nest. He stated that it would be converted into a shopping center. We were very surprised by this. The US still uses the Olympic stadium built for the 1932 games and Germany still uses the stadium built for the 1936 games.

Our guide seemed surprised at our surprise. He stated, “Well, there are other stadiums we use.”

As we were touring the 2008 Olympic Games sites, we discussed the impact of the games with some tour guides. We speculated that they must have been very busy with the increased tourism from the games. All the guides commented that during 2008, foreign tourism actually declined. They stated their belief that the government was genuinely pleased to have the games in Beijing and that the government was happy with the television coverage, but the government really did not want to handle a large increase in tourism. One guide said, “Television is easy to control, but large crowds of people are not.” Everyone believed that the government was concerned about something reflecting negatively on China’s image.

Concern about image is not unique to China. Our students reacted negatively to questions posed by their Chinese counterparts. The problem is that our students and their students approach the world through different cultural contexts.

IMPACT OF CULTURAL CONTEXT ON DOING BUSINESS

Understanding the cultural context of one’s trading partner is an important step in doing business. In China, it is important to become friends before we do business. The Chinese refer to this as Guan Xi (pronounced GWON SHE). Roughly translated, it means personal relationships are the most important thing in doing business. Chinese business people do not compartmentalize personal and business friendship. Someone wishing to do business in China must first make friends with potential contacts.

This can be tricky.

Chinese and Americans view different topics as taboo. For example, an American might casually ask about an acquaintance’s family (wife, children, relatives, etc.). In China this is

---

14 Anecdotally, we found one reason was the government’s control on visas during 2008. This trip was canceled due to the earthquake. Before the trip was cancelled, we were required to submit more information than we ever had before or since.
viewed as a deeply personal and not a proper topic for conversation. On the other hand, my Chinese friends do not understand our reluctance to voice our personal views. I have been asked point blank questions about my views on politics and religion. The questions about religion are especially surprising considering the lack of governmental openness with regard to religion.

One of the most interesting differences is shown by the way mail is addressed in China as compared to the US. In China, addresses begin with the macro and move to the micro. They begin with the country, followed by the state, the city, the street and finally end with the person. We begin with the person and move to the more macro. This indicates that group identity is very important in China while in the US, individual identity is most important.

Additionally, Chinese tend to express ideas indirectly and visually rather than directly and verbally. In our students’ coursework, there were many examples of this. For example, we saw a Chinese-produced video, but we were given no information concerning the purpose of the video prior to our viewing the video. It began by talking about the vast history of China, China’s importance in world events, and Beijing’s importance and culture. About 10 minutes into the video, it began talking about Beijing University. It turned out that the video’s purpose was to advertise Beijing University.

Our students experienced these differences directly so that they would better understand the issues of doing business in a foreign culture. Students learned to incorporate the Chinese view of things when students presented their results. They also discussed the needs for change in Chinese marketing if it was going to appeal to western audiences.

CONCLUSION

The purpose of this paper was to review the changes in China as a result of her moving to a more free-enterprise approach to doing business. I expect that as time goes on, additional changes will occur. This may include political hoped-for freedoms that would match China’s current economic freedom. In the future, our international business programs will continue preparing our students to help local businesses deal with the challenges of the global marketplace.

Finally, it will be my privilege to lead the China Internship for 2010. We are expanding the program to attract business, economics and accounting students throughout the state and throughout the nation. If you are aware of a junior or senior student in these fields that would benefit from the program, please encourage them to apply to me.